Chapter 1: Origin, Occurrence and Production of Petroleum and Natural Gas

Oil Sands

- A mix of sand and bitumen
    - Formed by accumulation of tiny creatures buried in ancient seabed → this is pressure-cooked into oil, which then migrated upwards and was trapped beneath the overburden
    - Bitumen is the heavier stuff left behind after the light crude made it to the surface. Sand particles in the middle, water and hydrocarbon aggregate bonded to the outside
    - Mostly accessed by open pit mining
- high concentration is most efficient, but for sustainability purposes, ERCB requires low concentration to be mined as well
- Extraction process:
    - Bitumen requires larges molecules split through hydro-cracking or coking (removing carbon)
    - Cracking generates vapours that have to be separated or condensed into liquid form
        - Naphtha, kerosene, gas oil
        - Sulphur is removed in refining process
- **In situ development**
    - SAGD
    - Cyclic steam stimulation
    - VAPEX
    - Toe-to-Heel Air Injection

Oil (more conventional plays)

- Usually any string over 5 carbon atoms (more energy)
- A distinction: light vs heavy
    - Light crude is easier to refine
    - Features to be measured: viscosity, density, specific gravity (API)
- Sweet vs sourcrude:
    - Difference = sulphur content

Shale Gas:

- Shale = rock with fine grained particles
- Tight source rock may be best prospects
- Drop in pressure required to separate gas from the bitumen
- Needs to be fracked, usually

Oil and Gas are FUGACIOUS resources: they move around

Common Gasses:

- Methane CH4
- Propane C3H8
- Butane
- Sour gas H2S

Role of Canadian and Albertan Oil

- Five phases
    - Phase 1: 1946 - 1972: oil seeking markets (too expensive to sell Alberta oil)
    - Phase 2: 1973-81 Opec crisis (massive boom)
    - Phase 3: Late 1980s: Federal response to oil boom and NEP
    - Phase 4: 1984 to present: Market directed approach to energy
    - Phase 5: 2000 to present -> Emergence of new technologies and consumers
- Oil boom and discovery in Canada around the beginning of WW1, but a lull of inactivity until 1946
- US became hooked on cheap energy as it found substantial amounts of reserves in places like Texas and Oklahoma

    - This is partly why the US still focuses on getting oil as cheaply as possible
- Energy is vital to all US politics as it has a direct impact on things such as domestic security and the broader economy
    - Energy remains the cornerstone to all US economic policies
- Treaty of Versailles was charged with the fact that the Ottoman empire was part of the enemy, and it fell apart after the war (1918). The Arabian Peninsula that made it up was divided up by arbitrary lines on the map, forming places like Iraq, despite ethnic problems that may result because of the arbitrary manner of creating the countries. There are obvious repercussions as the oil reserves, discovered as early as 1901, would be highly sought after.
- Companies like Chevron (then Standard Oil of California) were purchasing oil rights as early as 1901.
    - Exploration and production rights granted over vast tracts of land for nominal payments
    - Political effects
        - Huge discontent (helped create nationalist movements in most countries involved)
        - Foreign administration are imposed on these countries and their sole purpose was to keep the oil cheap and keep the place stable (e.g. British governance to keep oil from Iraq cheap). Western control of government and resources lead to increasing amounts of hostility and resentment.
            - 1953: Iran's Sha was disposed by US and UK forces
- Situation prior to Canada having even discovered oil would have a huge impact on the discovery of oil in Canada. World was awash in cheap oil.
    - 1946: oil discovered in Canada (Leduc), however there was no huge rush for it as it was slightly more expensive and landlocked
        - Phase 1: AB primary concern was finding markets that would buy it. Canada developed a national energy policy based on the **Ottawa valley rule:** No importing oil for those east of the Ottawa Valley to encourage use of Canada Oil (this rule was held up in court)
            - Gas was also begin produced at this time, however there was next to no demand.
            - 1958: Pipeline debate on a national scale regarding whether the gov't would build a Transcanada pipeline
    - 1973: price of oil did not change between 1946 - 1972. The mentality was the the price would never really change. Then OPEC gained power. OPEC started to choke off supplies until the price reached a level that they thought was fair. The US psyche was maimed by this with vast gas shortages throughout the nation.
        - Why did OPEC do this in 1973?
            - history of concession agreements (above)
            - lingering resentment caused by the political and economic control by the West
            - precipitating factors were a few wars including the 6 day war (Israel backed heavily by Western powers); Yom Kippur War
        - This began to create substantial inflation across the global economy
        - Conversations first started around this time, and the US started talking about things like max fuel consumptions on cars
        - Suddenly the value of AB oil was doubling and trebling → AB suddenly became an energy based economy
            - 1973: AB Leg decided that existing *fixed* royalty rate is abolished, and Lt Governor would periodically set the rate from now on (e.g. in 1974, it could be as high as 50% of revenue generated by the oil discovered) → gave Legislature the ability to conduct reviews from time to time
                - Doing basically the same thing as the Arab nations
            - Rest of Canada was suffering from vast inflation, which started a sense of national resentment towards AB (political time-bomb)
        - Mid 1970s: Economic nationalism and anti-corporation sentiments were rampant in Canada especially that the oil profits were going to the US
            - 1975: Petro Canada is established as a national champion. Canada bought a Belgian oil company (would not dare attempt to buy Shell (American) or BP)
            - 1977: Concern that there would be an oil crisis within 10-15 years
    - Oct 1980: NEP (National Energy Program)
        - Goal was domestic self sufficiency in terms of oil supply, increase fed gov't revenue from industry and to promote Cdn ownership of a US dominated market

        - Features include:
            - Fed gov't to obtain excess profits through a petro and gas tax which was based on 8% revenue (not profit)
            - Refineries were given subsidies to cover the difference between national and world prices
            - Natural gas: companies would be able to keep the domestic price however any difference with the world price would be kept by the federal government
            - Every company that holds Cdn lands, unless Cdn company, the gov't will take back 25% of its interest without compensation.
        - Brought the industry to a crashing halt as it was no longer worth it to produce, which meant the gov't didn't get the revenues it expected which meant that the subsidy the gov't was expecting to cover with the revenues had to be paid for through other funds
    - 1982: Spike in oil prices caused by special events ($163/ cubic metre), caused due to the revolution in Iran and the Iran/Iraq war.
        - Saudi Arabia between 1981 and 1985 began a policy (continued today) to undertake policies aimed at smoothing the increase in the price of oil
            - Rationale was to prevent alternative technologies from developing that would reduce oil consumption
        - 1985: Saudi frustrated by "cheating" (failing to abide by quotas) amongst OPEC-member nations, so Saudi flooded oil markets (2.5 -> 5mm BPD)
        - Effect on Canada: Exploration became uneconomical, high federal government taxes and lower global price of oil.
    - 1984: Mulroney elected, removed the personnel and philosophy of the NEP (program completely dismantled by 1986)
        - Market should be the driving force behind the price of oil, not the government (equalizes supply and demand). Not shielding people from the high prices will lead naturally to conservation.
        - Pre-1986: Export restrictions (greater than 15 year domestic supply required before exports allowed)
            - Resulted in a reduction of exploration
        - 1986: Export restrictions abolished, Canadian producers allowed to exploit highest domestic or international price of oil
    - 1990's: Alliance pipeline (Alberta to Chicago) transported massive amounts of *natural gas*
        - 1991/1992: Iraqi invasion of Kuwait, spike in oil prices
        - Remainder of the 1990's fairly steady decline in the price of oil until 2000 (in 2000 oil prices reached 1986 levels)
        - Oil as low as $8.64/barrel in December 1998 (accusations of Saudi flooding oil markets)
    - 2000's: Significant increase in consumption (China and India develop as emerging markets)
        - Geopolitical events: 9/11, Iraq war, terrorism
        - 2007/2008: Huge spike in oil prices ($147/barrel)
            - Conservation effects reduced prices
        - Higher oil prices brought about an emergence of new technology
            - Directional and Multi-well drilling, as well as hydro-fracking
        - Production of shale gas wells has lead to a reduction in both oil and mainly natural gas prices
    - Appears clear that North America is returning again to an abundance of oil and gas
        - Makes it very important for Alberta to develop export opportunities to international markets without depressed oil and natural gas prices
        - This is the reason for the amended CEAA, Fisheries Act, etc.
- It is important to remember that there are various international prices of oil and gas; although there is an inherent value in a barrel of oil the value is driven by the type of oil required at the time
    - Three Factors (measurements):
        - WTI: West Texas Intermediate
            - Landlocked. Can't export.
        - Brent Crude Price: North Sea Crude Oil (Europe) (available on the world market, and thus a bit more expensive because there's a bigger market)
        - WCS → Western Canada Select: Heavy crude (bitumen)

        - Edmonton Par (light): Alberta Oil
            - Light (easier to refine), sweet (not much sulphur) crude oil so it is highly valued
            - Much of AB production currently is heavy, crude oil (which requires more work to get it to market)
            - Same problem as WTI: it's landlocked and not available to a big market. Can't even get to the States properly.
            - Gradual decline in the conventional production of oil in the past decade; more focus on the oil sands production but then in 2011 advances in production and drilling (along with hydro fracturing) has started to increase conventional production again
            - The heavy oil is called Western Canada Select
    - Natural gas and oil prices are no longer moving in lockstep together

World Energy Reserves

- In order to qualify as part of an oil reserve, the oil has to be producible and recoverable with current technology
    - hence, the oil sands only recently became part of the Cdn oil reserve

Liquid Natural Gas (LNG)

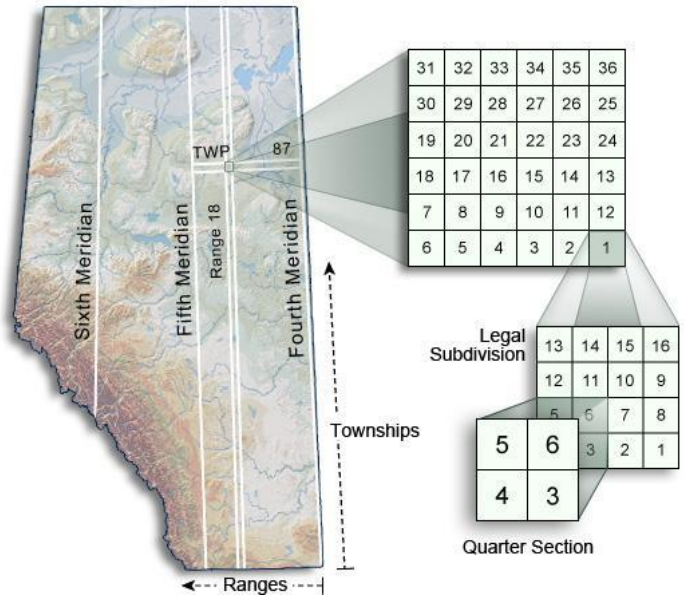
- LNG: Is natural gas that is cooled to the point where it condenses into a liquid (-160 c)
- After cooled to a liquid it takes 1/600th of the space required to store as a gas
- LNG can be stored and shipped safely because:
    - Colourless, odorless, non toxic liquid

Non-pressurized, non-corrosive

Chapter 2: Ownership Interests in Oil and Gas

(1) THE INFLUENCE OF SETTLEMENT ON LAND TENURE

Common Systems of Surveys



- In the prairie provinces (AB, SK, MB), lands are surveyed with respect to meridians of longitude and latitude
- A township is 6 miles x 6 miles and contains 36 **sections**
    - Townships are numbered northwards from the 49th parallel (Canada/US border). A column of townships is called a range, and these are numbered from east to west (beginning at zero for every meridian)
- A **section** is a square area of ~640 acres and contains 16 legal subdivisions
- L.S. 16 of 33-37-24-W4 refers to Legal Subdivision 16 of Section 33, Township 37, Range 24, West of the 4th Meridian

Land Survey System in More Detail

Starting point is the 49th parallel. Surveyors said that they will lay out a baseline every 24 miles north of the 49th parallel (which is itself a baseline).

-lay out a correction line every 12 miles north and south of a baseline

-lay out 2 TWP lines north of each baseline and 2 TWP lines south of each baseline

-Range Roads of longitude are laid every 6 miles from the 1st meridian (this runs through Winnipeg)

-in AB, we start at the 4th meridian

-because Range Roads of longitude are laid every 6 miles from each meridian, and township lines are laid every 6 miles north of a baseline, each township is 36 sq. miles

-Now ask: what happens within a TWP? Each TWP is divided into 36 sections. SE corner is number 1, number 6 in SW corner, number 7 is above number 6, number 18 is above number 7, etc. (this is called numbered "sinusoidally")

-Each section is divided into 16 legal subdivisions (LSD's) numbered sinusoidally (reason that this is important is because there are often competing legal disputes in regards to location of wells and neighbours draining from nearby)

-HB CO. has section 8 in each TWP. It also has the west half and the SE quarter of section 26.

-presumptive rule, because HBC only gets that land in 4/5 townships

-to make it an even 1/20th of the land in the fertile belt, the rule is that HBC gets all of section 26 in each townships divisible by 5.

-ie. townships 5, 10, 15, 20...

-Note: Correction lines/baseline are inserted because the grid is on a sphere. RR's will eventually meet at the north pole, therefore the top edge of a township at the correction line will be slightly shorter than the township's bottom edge

(2) THE DEVELOPMENT OF RESOURCE OWNERSHIP IN WESTERN CANADA

The Settlement of Alberta

- In 1905, Alberta became a province and in
- 1930 the power to grant surface and mineral rights was transferred from the Dominion Alberta
- Alberta **now leases but does not sell** any of the mineral rights

Royal Proclamation, 1763

- Crown owns all land except if land is granted to an other → by default, land is vested in the Crown
    - In US, could acquire land by settling on it.
- Our first critical document is the Royal Proclamation of 1763
    - Still important today because it says that you cannot acquire Indian Lands as a settler
    - Indian Lands can only be acquired if they have first been ceded to the Crown

Calder v. A.G. of BC **(SCC) 1973**

- Royal Proclamation applied to all of Canada, including BC.
    - This was interesting because BC did not exist in 1763
- Effectively the origin of aboriginal land rights in Canada
- Aboriginal lands = aboriginal lands until ceded to the Crown

Land Ownership in the Prairie Provinces

- In 1670, the King of England granted lands, including minerals, draining into the Hudson's Bay to HBC
- In 1837, the Crown began giving local autonomy to the western colonies
- In 1867, the provinces already owned the land and natural resources *(s.109 of the BNA)*
- **In 1870, the Hudson's Bay Company surrendered Rupert's land to the Crown (300,000 pounds), in exchange for approximately 7 million acres or 1.75 sections in each township**
    - **The Bay retained 1/20th of the lands in the fertile belt** (the surface and natural resources below)
        - 1st privately owned mineral rights in Alberta
    - This basically created a hole in federal land ownership because all of the land east of Rupert's land (Ontario and the Maritimes) and west of Rupert's land was owned by the provinces
    - The beginning of the divvying up of land ownership
- 1870 the government created the province of Manitoba (small in size, approximately the size of Winnipeg)
- In 1871, BC granted a 25 mile ribbon north and south of the rail track to the federal government as their price for entering confederation.
    - This resulted in the railway companies receiving surface and mineral rights in about 10 million acres of land
- Up until 1884, the Crown granted petroleum, natural gas and other mineral rights to homesteaders moving west. **By 1891, no homesteaders were given M&M rights**
- Today, nearly all mineral rights in the Territories and BC belong to the Crown, while **~81%** of minerals rights in Alberta belong to the Crown
    - 9% is owned by the federal government, and 10% is owned by individuals
    - 90% of this course deals with 10% of the land
    - Because Manitoba was settled first, then SK and then AB there is a declining number of freehold MM as you head west
- 1905: New BNA Act, federal gov't creates Alberta, Sask, and Manitoba, but when the three provinces are created the federal government reserves all mines and minerals
- **Up until 1908, when the railway companies sold lands, they would grant a full fee simple. From 1908 they began to reserve all coal and valuable stone; by 1910, they would reserve coal, petroleum and natural stone**
- 1911: Ontario and Quebec were expanded. In the expanded lands the two provinces were granted M&M. This created resentment in the prairies, and is basically the origins of western resentment of the east.
- 1930: **The Natural Resources Transfer Agreements** placed western provinces (except BC) in the same position as the other provinces with respect to natural resources, by transferring all mineral rights (other than in federal parks and Indian reserves) to the provinces, subject to those restrictions in the BNA Act

- The NRTA included two big exceptions:
    1. Provinces have to <u>respect the existing federal grants</u> 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.
        - Ie. mining leases. Heavily litigated, but not a big deal for the most part because a lot of these grants expired after 25 years.
            - i An exception to this are water licences. These do not expire.
    2. Each province was required to set aside enough land to allow Canada to fulfill its <u>outstanding obligations under Indian Treaties</u>

- 1956: Although the federal government had transferred ungranted land and resources to the provinces in 1930, the pipeline issue brought them back into the picture with respect to interprovincial commerce
- (NOTE: any time you are looking to transfer oil over provincial boundaries the Trade and Commerce power (Federal power) in the Constitution may be a factor. This is the most important power the federal gov't has in regards to oil and gas production. So the only solid legal ground the provinces could fight back against something like the NEP is through the amount of production as this is the ability of the owner to do so (and likely the only Constitutional way that they could))
    - They created the National Energy Board, which deals with any energy issues with an interprovincial dimension
- Today, the federal government's interest in energy production is primarily environmental (ie. climate change legislation)

<u>Six exceptions to the statement that the provinces hold title to M&M:</u>

1) Lands owned by HBC
    a. Then sold to locals
2) Lands owned by the railways
    a. Then sold to locals
3) Lands owned by homesteaders under which M&M were granted (before 1891)
4) Grants under odd bits of legislation which still included M&M rights (ie. Soldier Settlement)
5) Indian Reservation land
6) Potential claims under Natural Resources Transfer Agmt.

(3) BASIC OWNERSHIP THEORY

Problem: who owns the minerals beneath the surface? Do we apply *cujus est solum*? [NO]

Theories of Ownership of Oil and Gas (1953 Article)

- ISSUE: the substance is mobile/fugacious; underground can cross property division.

Three AMERICAN Approaches to the Petroleum Lease:

(1) Texas: The petroleum lease is a separate and absolute fee simple

- Absolute until someone draws it away
- Defeasible fee simple → owner is liable to lose if someone else draws the oil away through another well spudded into a common pool
    - The title is also misleading b/c fee simple tends to carry stronger implications

(2) Pennsylvania (MAIN VIEW TODAY): The petroleum lease is something less than a fee simple. <u>Ownership is not absolute until the oil is actually brought to the surface and reduced to possession</u>.

- The right granted includes an **<u>incorporeal right to explore</u>** and vests title when oil is reduced to possession.
- Petroleum is viewed as a chattel real, a *profit a prendre*, and is therefore an interest in land.
- Recognizes the fugacious nature of oil and gas and refuses to impose strict ownership rules that will clash with the scientific reality of the substance

(3) Oklahoma: Petroleum leases are regarded as exclusive grants of rights to explore, conveying no interest in land.

- Compares oil to a wild animal and therefore cannot be owned until it is captured.

Canadian Courts:

- Generally endorse the Pennsylvania theory, and Ontario Courts have held that oil is a profit a prendre
    - AB hasn't ever officially defined it as such, but the language in decisions indicate as much
- gas can't be owned until it's reduced to possession (*Borys*)

Landowners Mutual Minerals Ltd. v. Registrar (1952) [Contemplated severability of title]
FACTS: LandOwners owned M&M. Wanted to transfer M&M rights. Registrar said no b/c fugacious substance.
ISSUE: Can the interest be transferred? Or is it a rule of capture?
Ruling: Yes! If you own the Mineral Rights to your land, then you can transfer them.
RATIO: Oil & Natural Gas = minerals for the purpose of *Land Titles Act*.

- **If M&M are in the earth, ownership can be transferred by whoever owns the rights**

Reasons: The SK court looked at the Mines and Minerals Act and the Mineral Taxation Act. No statute that narrowed the definition of "mineral". Mineral is broadly defined, and LTA contemplates that you can issue a title for minerals or any mineral

- Mineral = something that can be got from the centre of the earth for purpose
    - Can sell rights to all minerals, or any minerals
- Mine = space around a mineral
- No ability to exclude others.
- Defeasible interest – defeasible by the legitimate actions of a neighbour on their own land
    - **Can't prevent your neighbour from drilling into the same reservoir.**
        - So long as it is a legitimate shared reservoir—no angle drilling.

Aftermath of *Landowners Mutual*

- No exclusive possession over rightful O/G until obtained at the surface
    - Can draw O/G from neighbour's property (shared reservoir) without punishment
- SPINDLETOP: everyone cramming into a space to drill
    - B/C no one wanted to lose their oil to their neighbour, build more and more drills
    - THEN, Risk of collapse.
    - Urban oil forest in LA → stems from tragedy of the commons; governments intervened to protect the resource through legislation
- Alberta responded to this decision by enacting the OGCA and OGC regulations

***Cabre Exploration v Arndt* [Need separate consideration to access land]**

- Operator is required to pay the landowner consideration for the right of entry

Oil and Gas Conservation Act and OGC Regulations (Alberta)

- DSU – Drilling Space Unit; prevents too many wells being drilled – places max number of drills
- Target Area – tells you where the well must be drilled. Focuses on where the drill bottom ends up, not the surface.

Section 4: Purpose
(a) **conservation**
(b) **safe and efficient practices** in the locating, spacing, drilling…

- Essentially says that the province can tell a property owner **where to drill a well**

(c) **economic, orderly and efficient development in the public interest**

- Can regulate **how much oil** can be produced

(d) to afford **each owner the <u>opportunity</u>**
(e) to provide for the recording of information regarding O/G resources
(f) to control **<u>pollution</u>** above, at or below the surface in the drilling of wells and in operations

- Two bodies in control of pollution (EPEA, which is composed of the NRCB and EUB)
- Power of ERCB over environmental regulation is huge
- Alberta Environment is there, but Energy Resources Conservation Board (ERCB) conducts the hearings

- Formerly OGB, ERCA, EUB, but now referred to as:
- **AER – Alberta Energy Regulator – ALWAYS THE SAME BOARD, DIFFERENT NAME**

Mechanism of enforcement: Get a license (section 11), and follow the regulations thereafter

How does the OGCA Achieve its Purposes?

(A) Drilling Space Unit

- The minimum area allocated for the purposes of drilling a well. The purpose is to effect the efficient recovery of oil
  - Space between wells sharing a reservoir.
- **DSU OIL** :1 well per 1/4 section
- **DSU GAS**: 1 gas well/section
  - New Gas Rule: 2 wells/pool/DSU
- Can apply for smaller DSU s 15(3)
- **RECENT DEVELOPMENT:** In November 2011, the government abolished spacing requirements for coalbed methane, shale gas, and low quality gas reservoirs
  - Rationale: The nature of these deposits required multiple wells for optimal production

B) Assignment of a Target Area: area w/in a DSU WHERE THE WELL BOTTOMS OUT

- **Purpose:** Maintains approximately equal spacing between wells
- Target areas promote: **(1)** equitable withdrawals and **(2)** reduces drainage across lease lines
- Must distinguish between (i) non-agriculturally productive land and (ii) agriculturally settled land
  - These are shown on a map in Schedule 13 of the Regs.

  (i) Non-agriculturally productive land (includes Fort McMurray, non-urban areas)
  - Pre-2011:
    - Oil: centre of DSU (centre of 1/4 section)
    - Gas: w/in centre of DSU [aka a section] ((w/in LSDs 6, 7, 10, or 11)
    - **Key point**: TA's are the centre of the DSU
  - 2011- Present:
    - Oil: 100m from all boundaries of the DSU
    - Gas: 150m from all boundaries of the DSU
      - CAN APPLY FOR EXCEPTION (DP: don't need to know the deets)

  (ii) Agriculturally settled land (the "Green Area" includes GP, Peace River area, Edmonton, Calgary)
  - Pre-1981:
    - Same as above Pre-2011
  - 1981-2011:
    - Oil – NE ¼ of a ¼ section (LSD 6, 8, 14, 16)
    - NG – central part of section (LSD 6)
  - 2011-Present:
    - same as above
- Penalty: Imposes a penalty for a well located outside of the target area, via a reduction in your allowable production. This is meant to increase the efficiency of total recovery, and to assure that everybody will get their fair share of the reservoir (Regs. 4.030)

Section 11: No person shall drill a well unless a license has been issued by the Energy Resources Conservation Board and is in full force and effect.

Section 15(3): No person shall apply for a licence for a well for the purpose of obtaining production from the same pool as that from which another well is obtaining or capable of obtaining production in the same DSU

- Recall: DSU is defined in the Reg. 4.020. Normal drilling spacing unit for oil is ¼ section; for NG 1 section. This is a presumption, you can override it
  - Reg. 4.040: The board cannot reduce the size of the spacing unit unless the applicant shows that
    1. Improved recovery will be obtained,

2. Additional wells are necessary to provide capacity to drain the pool at a reasonable rate that will not adversely affect the recovery from the pool
3. The DSU would be in a pool in a substantial part of which there are DSU's of such reduced size; OR
4. If in a gas field, increased deliverability is a possibility.

- These are technical criteria and the onus is on the applicant.

Rateable Take of Gas

- The Board may, by order, restrict the amount of oil and gas that may be produced during a period from a pool in Alberta (s.36(1))

Problems after the Spacing Unit was Enacted:

(1) Pooling ss. 80-84: combining tracts of land to form a DSU

- **Example:** 4 Quarter Section, 4 owners Oil Co drilling in LSD 6, but find gas!
- **Voluntary Pooling:** Where the quarter section owners enter into an agreement to give the rights to one of the owners in exchange for a percentage of the oil and gas.
  - This could result in a holdout problem
- **Compulsory Pooling:** Used when voluntary pooling fails due to a holdout. The owner of a tract within a DSU may apply to the Board 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 (s.80)
  - Preliminary Steps:
    1. Must show that you cannot make an agreement on reasonable terms, and must provide detailed particulars on why you failed to reach an agreement
       - Regulator will ORDER that the lands be brought into the DSU
    2. Must sort out who is going to get what share of production. **default rule** = shares allocated on an area basis (s.80(4)(c))
       - This is called a royalty interest, which is a cost free share of the production
       - The issue with the presumptive rule is that there may be no gas under one of the ¼ sections. It can be overcome if it can be shown that it is inequitable,
         ie. by demonstrating that the reservoir characteristics do not justify an equal split.
    3. s. 80(7): Order of compulsory, Production on one quarter section of land ***deems*** that there production on the other sections as well (allows for valid leases on the other ¼ sections, so they don't expire due to non-production);
       - CAUTION: section only applies when an *order of compulsory pooling*, NOT voluntary pooling)

Key point: Voluntary pooling or compulsory pooling are two ways to solve the above DSU problem.

(2) Unitization ss. 78 and 79

- **Definition:** Voluntary combining of DSU`s to form a field with the objective of exploiting the field through the minimum number of wells possible.
  - Each landowner gets paid according to their production.
  - Encouraged, but not mandatory. Usually the largest land owner becomes the operator
- **Example:** The energy company has a gas lease overtop of a pool of gas, and is confident that it can drain a pool using a well on its existing DSU. However, the 8 surrounding sections (owned by different parties) could use a well and drain the pool also.
  - The agreements are usually profit sharing based on "participation factor" based on reservoir maps
- Under s. 4 of the OGCA, efficiency is a concern. The solution to this problem is unitization. but discovers that the adjacent sections cover a pool
- In Alberta, unitization is voluntary (contractual), and is obviously encouraged by the Board (s.79)
  - In Saskatchewan, compulsory unitization exists
    - Attempted to pass in AB, but never proclaimed.
- You must inform the Board of what is going on by filing unitization agreements

(3) Indirect Monopolization

- **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
- **Solution:** Access to transportation (common carrier – pipeline), refining facilities (common purchaser) and processing facilities (common processor order) resolve the problem of indirect monopolization.

(i) Common Carrier ss. 48-49

- **Rule:** You cannot deny service to any customer if the customer is willing to pay the established price
- An application can be made to the Board to have a pipeline declared a common carrier. As a result, no proprietor of a common carrier can allow any discrimination of any kind against any person attempting to have oil or gas transported (s.48)
    - They cannot even prioritize their own interests (s.48(3))
- The only relief afforded to a common carrier is on the basis that the oil and gas is of inferior or different quality/composition
- EXAMPLE: Shell is sending Oil for an entire section except for one ¼ section through a feeder system (ie. pipeline), ¼ section owners apply for the Order, result = larger owner cannot deny shipping their oil for them (so long as ¼ owners pay their fair share)

(ii) Common Purchaser ss. 50-52

- Applies to a person who purchases, produces, or otherwise acquires oil produced from any pool in AB (a refinery)
    - An application can be made to declare a party as a common purchaser
- In other words, a refinery can be deemed a common purchaser, which means that they must purchase all oil offered for sale to it without any discrimination (s.50)
- The only relief afforded to a common purchaser is on the basis of inferior or different quality/composition (s.52)

(iii) Common Processor ss. 53-54

- The owner/operator of a processing plant can be deemed a common processor, in which case they must process all gas brought forward without discrimination (s.53)
- The only relief afforded to a common purchaser is on the basis of inferior or different quality/composition (s.54)
- EXAMPLE: “We will only process Shell Gas” – get an order, & cannot discriminate.

Introduction to Ownership Issues

Three different points to qualify natural gas:

1.) Surface test: what is the state of the substance when it reaches the well head? This would typically yield more vapour NG
2.) Original reservoir conditions: what was the distribution of substances prior to production?
3.) Bottom of well bore: in what condition does the substance enter the well for production?

- #3 = American favourite.

What Does a Typical Reservoir Contain?

- Free gas
- Oil reservoir
- Mixed reservoir (solution/evolved gas)
- Connate water at the bottom (will contain some dissolved gas)

Gas Cap Gas (Free Gas): Gaseous hydrocarbons existing at the top of the reservoir; remains gaseous throughout the production process and is a source of pressure to drive oil to the surface. In 1951, you could not produce the Gas Cap Gas until you had produced the oil from the well (*Borys* was one of few individuals who was able to capture the gas)

Solution Gas (Associated Gas): Gas that is liquid under the initial reservoir conditions, enters the well bore as liquid, but due to pressure changes/temperature changes in the well bore, changes to a gas and emerges at the surface as a gas.

- Original Reservoir Conditions Test: This is when you consider who owns what, and because it is in solution in the reservoir, it belongs to imperial.

Evolved Gas (Secondary Gas Cap Gas): Liquid under initial reservoir conditions, yet changes to a gas in the reservoir upon human intervention; enters the well bore as gas and emerges at the surface as gas. Has similar composition to solution gas, so it is difficult to determine the origins of each.

Borys v. Imperial Oil (1953) **[WE NEED A WAY TO APPORTION OWNERSHIP UNDER A LEASE; SUGGESTS WE LOOK TO INITIAL RESERVOIR CONDITIONS; ALSO USE VERNACULAR TEST TO UNDERSTAND WHAT WAS RESERVED]**

Facts: Borys acquired land in fee simple that had the following reservation on title: "all coal, petroleum, and valuable stone." This reservation was in favour of CPR who, in reliance of this reservation, leased to Imperial Oil all petroleum that might be found within, upon, or under the said land. Problem arises because above the petroleum is a layer of NG.
Borys believes that NG was not included in the term "petroleum" found in the reservation, and accordingly that they are entitled to it. Problem is complicated further because the NG, once recovered, will be mixed with the petroleum (pressure change causes some NG to turn from liquid to vapor form).
Issue: Who owns the NG beneath Borys's land?
RATIO: NG *in situ* = Borys'; but Petroleum owner is not obliged to conserve NG nor seek consent of NG owner if their use of the gas is reasonable and connected to the production of the oil; **characterization of the resource at initial reservoir conditions**
Imperial Oil is entitled to recover petroleum by ordinary and reasonable methods. This will involve incidental production of gas cap gas. They must have the right to do this because otherwise they would not be able to produce petroleum and their interest would be sterilized.
NG is defined by reservoir conditions in the ordinary meaning.
Result: Borys can recover the NG by any usual and customary manner, but cannot prevent Imperial Oil from following a similar course. Borys reached a settlement with Imperial Oil, because Borys' strategy would have been to immediately drill for natural gas. He got a 2.5% royalty

- **Ace in the Hole**: Borys can *also* go and get his NG.
- This will decrease the pressure in the chamber, and convert more of the oil into gas.
- Also sterilze the gas, but reducing the pressure making it harder to drill.

Reasons:

- The court had no difficulty accepting that the NG *in situ* belonged to Borys because it was not included in the reservation. This was found despite the fact that a key feature of ownership, possession, is not found. However, the issue remains of how to deal with the NG that exists in the solution with the petroleum.

- **Non-scientific interpretation** of Petroleum (liquid) & Gas (Vapour)
    - From a scientific perspective, liquid vs vapor NG are very close in composition
- Imperial Oil has a direct grant to the petroleum, and they are not under an obligation to conserve Borys's natural gas with the consequent denial of their right to recover the petroleum in the usual way.
- Even if it were conceded that the respective rights of the two parties are to work for and recover each his own property, it does not follow that neither can act without the consent of the other and that only by mutual agreement can they work at all.

Aftermath: Many companies had to go around and get NG leases to avoid the Borys problem.

- Now, following s. 39 of the OGCA, a NG lease must say that the NG owner will not produce NG until oil = gone
    - Cannot concurrently produce oil & gas cap
    - Why? NG creates pressure that aids in bringing the oil to the surface
- Essentially Sterlizes Rights of NG owner.

NOTE: CPR's reservation did not include a right to work. Despite this, the court held that a reservation by a landowner of the MM is meaningless unless it is accompanied by the right to work and recover the substance reserved. Accordingly, the Court gave Imperial Oil a right of access even though Borys did not consent.

- **An implied right of access**
- **This was reversed by the the *Surface Rights Act*, which has other requirements.**
    - **Can either get (a) consent of landowner (b) apply to the Surface Rights Board**
        - **Consent requires: separate consideration**
        - **Right of Entry: (a) fee (b) compensation based on (i) amt land occupied (ii) relative to adverse effects**

Other Issues:

- In situations where companies are actively capturing and selling gas cap gas there may be ramifications as they may be seen as converting and selling someone else's property, or are benefiting from property owned by someone else.
    - Based on production figures, can estimate how much cap gas and mixed gas there is in the usual reservoir.

General Ownership Points:

- Rule of Capture: Prevents A from having a claim against B when B captures from under his land a substances that was under A's land
- Ownership is a bundle of rights in Oil and Gas law:
    - Right of transferability (can sell/lease MM *in situ*)
        - Observed in LMM and Borys
    - Right to use as one sees fit subject to regulatory restrictions
        - A petroleum owner/lessee can drill for petroleum and use it as he sees fit.
        - IE. OGCA limitations on natural gas production w/o all the oil is produced (OGCA s.39)
    - Right of exclusion (but not of a shared pool)
        - We know by implication that the one thing you can't do is prevent others from draining your pool
- NOTE: It was argued in *Anderson v. Amoco* that Canada is not an ownership *in situ* jurisdiction and that no OG ownership rights accrue to a person until there is possession. According to DP, this is NOT the case

Current test for ownership of petroleum and natural gas: All liquid hydrocarbons in the reservoir at the time of the grant. This ownership principle needs refining to encompass "solution gas" and "evolved gas"

(4) SURFACE ACCESS

COMMON LAW:

Upon Severance of title to the minerals from the title to the surface = a right of entry ***arises*** (**Cabre Exploration Ltd. v Arndt)**

- A natural easement b/c No party would purchase a severed title to MM w/o right to work the minerals

STATUTORY CHANGE: NO ACCESS w/o SEPARATE CONSIDERATION

Surface Rights Act

Right of Entry:

- No operator has a right of entry with respect to the surface of any land until:

a the operator has **obtained the consent of the owner** AND the occupant of the surface of the land; OR
b has obtained a right of entry by reason of an order of the Board (s. 12(1))
i NOTE: The board only grants a right of entry in exchange for compensation (s.23), which is determined based on market value of the land and other factors (s.25)
ii Other factors include: Compensate for loss of profits, difficulties in farming, etc. any kind of adverse effect, damage to the land, surface area.
iii Compensate for surface disturbance

- Notwithstanding anything contained in a grant, conveyance, lease, licence or other instrument, whether made before or after the commencement of this Act, and pertaining to the acquisition of an interest in a mineral, an operator DOES NOT obtain the right of entry in respect of the surface of any land unless the grant, conveyance, lease, licence or other instrument provides a separate **specific sum in consideration for the right of entry** of the surface required for his operations (s. 12(2))
    - Must pay a separate sum for surface access.

Five Reasons for Granting Access: (one of which is not exploration)

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

Encana Corp v Campbell [SRB CAN RESTRICT USE OF LAND AS LONG AS THEY DON'T FRUSTRATE LICENSES]

- s. 15(6) of the SRA allows the Board to grant a right of entry onto certain lands, along with conditions to that entry, so long as the conditions imposed are not against the license granted to the licensee

(5) EVOLVED GAS

***Prism Petroleum v. Omega Hydrocarbons* [WHEN DETERMINING CHARACTER OF THE SUBSTANCE FOR DETERMINING OWNERSHIP, LOOK AT INITIAL RESERVOIR CONDITIONS → APPLIED *BORYS*]**

Facts: Prism (the appellants) entered into a unitization agreement for the West Provost Viking Gas Unit. Omega (the respondent) has two operating oil units within the boundaries of the gas unit. The unitization agreement includes: **petroleum substances and all fluid hydrocarbons not defined as oil** (this was a strange definition). **Oil** is defined as "crude oil and all other hydrocarbons regardless of gravity that are or **can be recovered in liquid** form from the unitized zone through a well by ordinary crude oil production methods." Oil can be dealt with by the owner as they see fit (not included in petroleum substances definition).
Key Fact: Omega acquired its oil rights after the unitization agreement was in effect. This means that the initial registered owners or lessee's from the registered owners could only convey to Omega those rights that were not already conveyed to Prism. Omega started producing oil in the unitized zone, and drilled 17 produced wells. Prism claimed ownership to the gas that was being produced from these wells.
Issue: (1) Is Omega violating anyone's rights by producing SOLUTION GAS along with its oil, or (2) Does the definition apply at surface or reservoir conditions?
RULING: Followed Borys: must look at the initial reservoir conditions. Therefore, the solution gas belongs to Omega

- BUT: Borys was not a case of general application, but it held that the ordinary meaning of petroleum at the time of the land transfer between CPR and Borys included all hydrocarbon liquid substances in the reservoir
- The Dispute was oversimplified – wording of the agreement should not have allowed for Borys application.

ANTI-REASONS:

- BUT, "petroleum" and "oil" may vary based on the agreement.
- FURTHER, Lease said "recovered in liquid form" – how can this *possibly* include liquid gas?
- Also: evolved gas – gas at reservoir conditions, but liquid when collected – this is ignored; deals only w/ solution gas.

***Anderson v. Amoco* (SCC)** (closed the evolved gas disputes) **[*BORYS* READ AS REFERRING TO INITIAL RESERVOIR CONDITIONS]**
Facts: In 1904, CPR recognized the inherent underground value of the land they owned. As a result, they began to reserve valuable subsurface minerals from title when they sold the land. Initially, they only reserved coal but by 1912 they were

reserving rights to all M&M. CPR then entered into agreements with settlers for the transfer of title to this land. Under these agreements, CPR reserved its right to petroleum, creating split title lands.

- In this case, the plaintiffs were owners of NG and argued that ownership of NG should be determined at the time the hydrocarbons enter the bottom of the well head. The gas owners tried to show that there was a developed theory of OG ownership → that evolved gas belongs to the gas owners since "Canada is not an *in situ* ownership jurisdiction."
- The petroleum owners 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.

Preliminary Issue: Gas owners start off (oddly) by trying to go back to the beginnings of petroleum law. Three choices: (1) surface STP (rejected in *Borys*); (2) initial reservoir conditions; (3) reservoir conditions as they change over time (i.e. at the bottom of the well bore). In Canada we have rejected surface conditions, so it is between the latter two.

Issue: What is included in a reservation of oil, and at what point in time should the determination be made? In other words, did the *Borys* decision pertain to original reservoir conditions or the condition of the hydrocarbons arriving at the wellhead?

Agreed upon issues (based on Borys):

1 The petroleum owner is entitled to all liquid hydrocarbons in the pool, while the non-petroleum owner is entitled to all hydrocarbons in gas phase;
2 Determination of ownership, based on phase, is to be made in the ground; AND
3 Petroleum reservation included an implied right to work and produce the product

RATIO: The reservation of petroleum included all hydrocarbons which were in liquid phase in the ground at the time of the transaction. (i.e. at the time the lease was signed, or at original pool conditions, **NOT at the bottom of the wellbore—when it entered the well**)

- *Borys evolved* to a principle of interpretation to a rule of law. Courts now apply *Borys* to a wide variety of litigation.
  - This case is an application of the holding in *Borys* that goes well beyond the issues in that case

REASONS:

- SCC applied *Borys* and confirmed *Prism* to find that hydrocarbon entitlement is determined according to initial reservoir conditions.
  - This was practical, as it would be difficult to determine ratios of solution gas to evolved gas, and ownership would be under constant change as pressure constantly decreases.
  - Also fits the logic of Borys, as we must look at the vernacular (laymans definition) at the time of the grant.

Problem: The boundaries of this case have been decided by the previous two cases. If the court in *Prism* intended to treat evolved gas differently than solution gas they would have done so

- Ownership theory is skirted, ie. it would make no sense to say that a substance with the same molecular structure (hydrocarbon) would change ownership upon a change in *phase.* This is like saying that ownership of water changes when it becomes steam
- Gas which emerges with connate water does not belong to the petroleum owner. Court of Appeal seemed to hint that under the Water Act, all water in AB belongs to the Crown. This implies a third owner of substances in the reservoir, which causes obvious problems but has been ignored

Ownership Summary of Split Title Lands

- **Petroleum owners:** Entitled to all hydrocarbons which were in liquid phase in the ground at the time of the transaction (grant/lease), in original reservoir conditions, regardless of the phase they are in upon recovery
- **Non-petroleum owners:** Entitled to all hydrocarbons which were in a gas phase in the ground at the time of the transaction (grant/lease), regardless of the phase they are in upon recovery
- **Rule of capture**
  - Oil does not have to be reduced to possession to become the subject of ownership; this was evident from *Borys* which declared that ownership exists before the reservoir is penetrated
    - This can be changed through contract
  - 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
    - Applying this rule to parties who have agreed to divide their interest under the same tract of land would defeat the purpose of the K. This is because if it applied, 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

- **Connate gas:** Unclear who owns connate water/gas; we know it doesn't belong to the petroleum owners, likely the gas owners.

(6) GAS OVER BITUMEN → Priority of bitumen production [RIGHT TO WORK, RECOVER AND REMOVE BITUMEN ENTITLES LESSEE TO PRODUCE GAS CAP GAS INCIDENTAL TO BITUMEN RECOVERY, EVEN IF NOT EXPRESSLY CONTEMPLATED]
Background: Crown Lease

- Bitumen has a significant gas cap, while the bitumen layer itself is thick like tar
- Government gave out bitumen leases (1970s-1980s), but realized there was lots of natural gas
    - Started to reserve the natural gas, and lease it separately (1981).
    - Treating the container like a layer cake.
- Deep Rights Reversion: the deepest layers that couldn't be reached were leased separately.
    - Gov't CONTEMPLATED Shallow Rights Reversion: basically, the people w/ "natural gas leases" could do the middle gas. Higher layer & lower layer would be leased separately (2009)
        - Never came through
    - ISSUE: the middle layers often "communicate" with each other through shared chambers.

PROBLEM:

- NG pressure required for non-surface mining bitumen extraction
    - Needed for Steam Assisted Gravity Drainage (SAGD)
- TWO ISSUES:
    - 1. NG was being incidentally produced during bitumen production
        - What are NG owner's rights?
    - 2. NG production was neturalizing bitumen production.
        - What are Bitument owners rights?

Key point: The government started to think that they could not allow NG production where the NG is overlying bitumen. Why? If the NG is produced, we may not be able to produce the bitumen

- Two disputes: NG owner – you are wasting my NG; government– we have to preserve NG so as to get the bitumen

Alberta Energy Co. v. Goodwell

Facts: AEC was producing the bitumen and Goodwell complained that AEC was using its NG. Goodwell claimed that AEC's production had a high gas to oil ratio (describes how much gas is being produced from any type of well versus how much oil is being produced). Goodwell actually hadn't done anything to drill for NG. AEC had made a significant investment in producing the bitumen. Prior to this case the EUB had shut in AEC's four bitumen producing wells in the interests of protecting Goodwell's NG rights.

Two parallel disputes:

1. Goodwell begins an action in ABQB, claiming AEC was producing their gas
2. Goodwell also goes to what was then known as the EUB (now ERCB), and claimed that AEC was creating a conservation issue, and also that they only had a license to produce bitumen (not natural gas)
    - EUB ruling: Gov't can't incidentally produce gas to get to bitumen. Requires GW consent to do so [contra *Borys*]
        - If no agreement, then bitumen well should be shut in

Issue at CA: To what extent can EUB shut in wells so as to prevent bitumen producers from producing gas-cap gas incidental to bitumen in a split title situation where bitumen rights and NG rights are held by different parties?
Held: AEC's express right to win, work, recover and remove bitumen under its oil sands leases entitles it to produce initial gas-cap gas incidental to bitumen recovery using ordinary reasonable methods of production, **subject to rights Goodwell may have for compensation for the initial gas-cap gas produced**

- Petroleum is just of a slightly different nature here.
- Court sees this dispute as being under the purview of *Borys*
    - ADDS to Borys w/ compensation

REASONS:

- administrative boards = granted a degree of deference and courts are reluctant to interfere with a board that has technical expertise
    - EUB is a board that has technical expertise,
    - little deference b/c issue = interpretation of Crown leases and well licences
- The EUB objected on on a few grounds, none of which were accepted by the court:
    1. ***Borys* is distinguishable on scientific grounds [**bitumen ≠ conventional oil]
        - FAILED: The role of initial gas-cap gas in bitumen recovery is similar to conventional oil recovery.
        - each party entitled to ordinary reasonable methods of production
    2. ***Borys* is distinguishable on statutory grounds**
        - The *MM Act* says that a person may not exploit a crown owned mineral unless authorized to do so under the Act or under a contract; therefore the bitumen owner only has a right to bitumen and not NG
        - FAILED: possible hold out problem with NG owner b/c bitumen owner needs the NG owner's permission
        - M&M Act does not take away common law rights of the mineral owner.
    3. ***Borys* is distinguishable on contractual grounds**
        - FAILED: *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.
    4. ***The timing of the Goodwell gas lease was irrelevant***
        - One argument advanced by Goodwell was that since the natural gas lease was granted before the Bitumen lease, the government incidentally could not grant a bitumen lease that would result in the production of gas cap gas.
        - This argument failed to account that a lease is a profit en prendre, meaning recovery of any substance is contingent on the effort and capital used to extract it. Since AEC had the right to recover the bitumen, and the gas cap gas was a reasonable and expected consequence of this recovery, the date that the lease was granted was irrelevant.

Key point: Despite Borys being about a particular grant at a particular time, it is the key case for distinguishing between all underground substances

Outcome: What is Goodwell left with? Court said that they can get compensation. EUB has an assumption that whatever is taken from the NG owner can be compensated for. The production of initial gas cap gas incidental to bitumen recovery is inevitable, but does not result in the destruction of anything. The gas can be measured and compensation can be paid.

- Is this correct? What is the assumption with which we are left from Borys? Get your own gas or you are out of luck
- DP says that unless the NG is being sold, there is no reason to provide compensation

***Gulf Canada Resources Limited Request for the Shut-in of Associated Gas, Surmont Area* (EUB Decision)**

Facts: Gulf /Conoco had a bitumen lease from the province, and the province leased NG to other companies. Gulf was concerned that the pressure depletion in the gas cap might affect bitumen recovery, so they applied to the EUB for an order to shut in associated gas production within a 3 section buffer of its leases. Surmont Producers Group objected, arguing that SAGD technology was too uncertain and that shut in is an overreaction. EUB shut in 146/183 several gas wells. In all tar sands areas, 938 existing NG wells were shut down in fear that the NG wells threatened the ultimate recovery of bitumen.

- Very valuable natural gas, & very valuable bitumen. BUT, if you produce NG 1st, might strand the BIT.

SPG's Argument:

1. Potential for resource sterilization is not in the public interest
2. It is not worth shutting in to protect a resource that has no current economic value
3. There were many other bitumen areas that weren't subject to shut in
4. The current market value of NG would be $190M and the cost of a shut in would be $11M to shut in the wells

EUB:

- The potential of resource sterilization is a matter in the public interest, which is part of its mandate (OGCA s.4)
- Recoverable bitumen reserves were roughly between 5.25 – 7.5 *billion* barrels whereas G reserves were 17-32 *million* barrels. Therefore, it is in the province's best interest to preserve bitumen.
- It could take 200 years to produce bitumen, but it is not reasonable to force bitumen development by requiring leaseholders to demonstrate commitments to bitumen projects within a given timeframe. This may discourage investment in bitumen projects

- The EUB was unwilling to rely on re-pressurizing depleted gas zones by gas injection, as feasibility had not yet been demonstrating. The same went for re-pressuring with water
- PRECATIONARY PRINCIPLE: unsure of SAGD technology, but want to err on the side of caution so as not to strand it.
- Decide to look at the Barrels of Energy equivalent – more energy in the bitumen reserve, so stall NG production.
    - Prevent production of one form for a potentially larger resource.
- Irresponsible to accept risk of resource sterilization
- If well is to be shut-in, doesn't need to shut in the entire well → can shut in at intervals

Compensation Issue: What would happen if Gulf produced the NG of the rightful NG owners? They would have to pay all of its value, but they are obviously not going to do this. Instead, Gulf (now Conoco) entered into the Agreement below:

Authorization of Agreement between the Crown and Conoco Canada Resources et al.

- The province may have had a good argument that there was no right to compensation based on *Borys* principles and also based on the fact that there was no expropriation of production, just a delay in extraction.
    - DELAY production: pay a sum of money now to CONOCO, but then GOV gets royalty when NG produced
    - Shut-In of 146 gas wells.
- Where the Board orders a shut-in, the operator is entitled to compensation → how much?
- Lump sum for interim use; once well is opened up again, operator pays back the lump sum as a gross overriding royalty until sunk costs are reclaimed
- BUT, Politically, the NG owners have huge clout – large O/G producers carry considerable influence and to not compensate these companies would be detrimental to future investment by these companies

The Agreement:

- **Para 5:** Crown must pay approx. $80 million to the owners of 146 gas wells. This must be paid through royalty rebates from other producing wells in the area or, if that is not enough, in the province.
    - This avoids having a politician write an unpopular cheque.
    - Amount is based on the net present value (NPV) of gas.
        - This is too much because the right to produce is not given up, it is only postponed.
        - Therefore, the NG companies granted the Crown a gross overriding royalty
- **Para 7:** Gross overriding royalty (GOR) = the normal royalty rate + X%. In this case it was 11%
    - Robyalty Rebate = for now (bitumen production); GOR applies later (NG production)
- **Para 12:** Conoco's slice of the $80 million pie is $20 million, and they do not write a cheque to the government. Instead, they pay a larger royalty on the Surmont leases. 2026 is when Conoco gets to start paying it back or when the revenue from the Surmont project exceeds the sunk costs. This is obviously hugely beneficial to Conoco
    - NOTE:Royalties are not technically royalties. Rather, they are a net profits interest
- Gulf Recognized that, overall, this was an extraordinary remedy (shut in of over 100 wells).
    - Most gov't revenue is the form of a royalty (a % of profit).
    - Oil sand revenue comes from a "net profits interest" due to high production costs until payout date (once the full cost has been covered), then gov't gets 40% profit.
- IF THIS WAS LITIGATED: Essentially a constructive taking, but not expropriation (kept title to their lease)
    - *Tenner v BC*: Tenner had minieral rights in BC, but gov't was creating a prov park in area.
    - Park became a no-mining area, and sterilized his mineral rights—he couldn't use it.
        - Didn't matter that title didn't transfer, it was an expropriation.
    - This is the ONLY significant CAN case where resource owner = compensated.
    - If the CROWN provides scheme compensation in legislation, then **no wrongful taking**.
        - Mineral Rights: if taken in AB, get compensation for costs but not lost profits

Energy Resources Conservation Board Order 11-202

- Similar to the agreement concluded with Conoco, in December of 2011 the ECRB made Perpetual Energy shut in a large portion of their gas wells to protect pressure depletion of Bitumen reserves.

(7) COALBED METHANE

Introduction

- Coalbed methane is very important in AB's future
    - A 2006 study by the EUB says that 410 trillion cubic feet of CBM was found *in situ* in EUB, with around 100 trillion cubic feet recoverable given existing technology
    - Main question is who owns CBM. There is no Canadian caselaw on this, but there is a USSC case
    - 91 billion tonnes of coal at depths suitable for mining in AB
    - additional 2 trillion tonnes at depth suitable for CBM exploration
    - possibly 500 trillion cubic feet of CMB in AB

CBM Science

- **Production:** Decaying plant material settles on the bottom of swamps and is converted into peat; the peat then sinks into the earth and chemical reactions increase the carbon content (coalification). This produces methane, and the porous character of coal permits the retention of this methane
- **Composition:** CBM is similar in composition to gas-cap gas and exists in 3 states: (1) Free gas; (2) Dissolved in water in the coal; (3) Gas absorbed on the solid surface of the coal held there by Vanderwaal's forces
    - Coal pores have a larger surface area than other rock, so more gas exists on this state on coal. There is a phase change during production. A decrease in pressure causes CBM to escape as coal is mined
        - This is why carneys die
    - Mostly CH4 (methane), but may have have nitrogen, CO2, and other heavy hydrocarbons.
- Largely confined to southern AB – Mannville Group (GP → EDM → Calgary), Mackay, Taber, Lethbridge, Drumheller, AB foothills
- **How do we get it?**
    - Unconventional: requires reservoir depressurization to release gas from the coal matrix and flow to a well
    - Can be produced through hydraulic fracking
    -

The CBM Dispute

- Americans have been producing CBM for a while
- 1900-1910 saw an energy panic w/ heavy coal reliance.
    - Started reserving coal (around the same time that CPR was reserving coal).
- US began to feel bad about taking land from Indian Tribes. Accordingly, the government restored land rights to the Southern Ute Tribe in the 1930's. Restoration included the coal that had been reserved from grants to settlers, however, where the settlers acquired the surface of the restored lands, they owned everything except the coal
- Following the OPEC crisis, the US gov't began to investigate the possibility of producing methane gas found in association with coal. The tribes claimed that since they owned the coal in these tracts of land, they also owned the CBM
- The dispute in *Amoco* is premised on these facts
- NOTE: Also Environmental concerns: Chance of allowing methane to escape into atmosphere, and high water use.
-

***Amoco Production Company v. Southern Ute Indian Tribe* (1999) US Supreme Ct. [APPLIED VERNACULAR TEST; CMB NOT INCLUDED IN COAL RESERVATION BECAUSE AT TIME OF GRANT IT WAS CONSIDERED A TOXIC NUISANCE; MAY BE INCIDENTAL RIGHT]**

FACTS: Land taken from Indian tribe, granted it back. Indian tribes then started started selling the land while reserving coal.

- Have to consider what was granted and what was reserved. If, as in the case of homesteader land, we have a surface owner who also owns mineral rights, but the previous surface owner has reserved the coal, then this would be the *Amoco SUTE* situation.

Issue: Whether CBM belongs to gas/surface owners or coal owners?

Test: To determine whether CBM is part of the coal reservation, the question is as follows: At the time of the grant/reservation (1906), what was meant 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 at the time of the grant

Held: CBM belongs to surface/gas owner and not coal owner.

RATIO: In 1906 to the ordinary reasonable person: (1) coal is a hard rock, and gas is something that exists in a vapourous state; (2) methane was understood as a distinct substance that escaped from coal as coal was mined, rather than a part of coal itself

- In a 7-1 majority decision, dissent takes the view that ownership should follow responsibility (ie. coal owners have been interested in methane for over 100 years)

NOTE: This case only deals with a federal reservation, and therefore state court decisions are not consistent with Amoco

What will happen in Canada?

- There is no common law precedent, so we should look to the specific facts and *Borys*
- Starting point is the *Borys* principle: What was the **common understanding** of the parties at the time of the grant? (vernacular test)
    - The likely result is that the coal owner doesn't own gas because gas is a different substance; NG owner is likely to own CBM in a split title situation
- If you were a desperate coal owner, what sort of things could you do to leverage your position?
    - If this is exploitable coal, go and exploit your coal resource. In reality, this is a red herring because a lot of the coal is not readily exploitable. This raises the question of whether the government should pass legislation preventing the exploitation of coal first.
        - Why? Coal will retain its value after CBM is extracted
- **Key Point:** Companies that own the coal rights are powerful (Teck)
    - In split title gas, if there is an indication that the NG owner plans to exploit CBM, the coal owner will launch a statement of claim (SOC) reminding the NG owner that the issue is not yet legally resolved. This is typical in AB.
    - This SOC is used by the plaintiff to negotiate an agreement for the coal owner to obtain a royalty from the NG owner
    - Some important companies have developed a portfolio of significant NG rights by obtaining leases from the Borys's of the world
    - Other thing that coal owners will do, is to try and de-emphasize the SC decision in *Amoco v. Southern Ute Indian Tribe*
        - Remember, these were federal lands. Instead, we should look at state courts. For example, Pennsylvania decided that CBM belongs to coal owner – but their grants are much more complex.
- **Strategy:** If you are a coal owner, try and find a grant that is a similar as possible to a title in a successful US case
    - Calgary and Edmonton Railway Co. gave out strange titles, so should be paid attention to
    - Also, look at other provision of the lease (rather than just the title). Even though they are less strong than the grant/title itself
    - EUB held a massive hearing in 2006, and the coal owners made an argument that you cannot grant well licences for CBM wells unless those licensees own the coal rights b/c CBM belong to the coal owner
        - **The EUB rejected this argument for two reasons**:
            - (1) Technical evidence shows that coal is a solid, CBM is stored in a gaseous state within the coal, but is not part of the coal
            - (2) Looking at the CL authorities, the NG lessee has a demonstrated entitlement to exploit the CBM
        - This was appealed by the coal owners immediately to ABCA. The appeal was abandoned after 18 months without reason

What about Crown leases?

- CBM is a form of NG, and the lessee of coal does not have any right to NG, except in the case of emergency venting
- S. 67 MM Act: Amendment says that a coal lease grants the right to the coal which is the property of the Crown, but does not grant any rights to NG including CBM
- AB Act is not retroactive
- What about leases that were existing prior to amendment? Still a live issue
- BC was much bolder in 2003 with the *Coal Bed Gas Act*
    - Coal bed gas must be considered to be and to have always been NG

-DP: no room for disagreement, whereas the AB act one does not end the disputes forever and only speaks from the date of the enactment

- NOTE: This only affects Crown leases, not freehold leases

Freehold Lease

- The "lease" was utilized as it was thought to best meet the requirements of the contracting parties. Grants to the lessee a smaller interest that a fee simple conveyance, yet confers a sufficient grant and term to permit the operator to remove any discovered MM
    - Also protects the interest of the mineral owner by imposing certain time limitations within which the operator must explore for/produce the MM
    - Gives the original owner a continuing interest by reserving a royalty
- The characteristics of the instrument do not appear to be a lease:
    - Conventional leases contemplate the use of leased property, which shall be returned to the owner in the same condition subject to reasonable wear and tear
    - With an MM "lease", the rights granted under a typical OG lease are entirely different, as the "lessee" must have a right to possess and remove the minerals

Re Bearspaw Petroleum Ltd. (2007) [INSTRUMENTS MUST BE INTERPRETED VIA VERNACULAR TEST; COAL OWNERSHIP DOESN'T = CBM OWNERSHIP]

Background

- Encana, as the owner of the coal rights, was arguing that the production of coalbed methane by the gas rights owner (Bearspaw) was unlawful as they were the owners of CBM

Issue: Was the mineral owner with gas or coal rights entitled to the CBM?

Analysis:

- The board did not provide an ultimate decision, as they deferred the ultimate decision to the courts
- The board determined that according to the *Borys* principle, the plain meaning of coal understood in the early 1900's was a solid substance (similar to the rationale in the US in *Southern Ute*).
- Definitions of coal that included CBM appeared to be a more scientific understanding of the fuel, beyond that understood by normal, prudent businessmen.
- The **vernacular meaning** of coal at the time did not include the presence of CBM.

Mines and Minerals (Coalbed Methane) Amendment Act, 2010

- s. 10.1(1) Coalbed methane is declared to be, and at all times has been a natural gas
    - (2) subsection (1) has no effect on pre-existing grants and leases of natural gas;
- This legislation appears to have halted any further litigation for the moment about the correct ownership of oil and gas (*Encana v Arc Resources)*.
- This was likely enacted because of pressure placed on the legislature by numerous farmers exerting pressure on their MLAs. There has been clear conflicts between agriculture and oil/gas interests for the last decade as the two vie for opposing interests. The agricultural forces have tremendous influence, and can out lobby the oil and gas industry easily because of its prevalence in the province.
    - Likely the best option for the coal owner is to produce the coal, this will cause the methane to dissipate
    - A crown lessee in coal does not have a right to natural gas
        - DP: Someone needs to consider how to encourage the recovery of CBM while the coal is also being mined

(8) STORED GAS

History

- **Consumer Storage (1950s):** Consumer storage was the natural reaction to the high demand for gas (which caused a high price) during winters. In the summer, demand was lower (and therefore, so was the price), therefore consumers were prompted to take advantage of this

- They could take advantage of the lower price by purchasing NG in the summer and then storing it in the winter. Furthermore, they could protect themselves from a gas shortage in the event that pipelines would not be able to handle increased demand
- Gas was stored by injecting it into sub-surface formations, and it was usually placed into empty gas reservoirs. These gas reservoirs were once impermeable (all wells but one were shut-in), so they could be sealed off where they had been penetrated by the well. Also, major salt domes in Fort Sask were used for storage

- **Producer Storage (1980s):** Suppliers began to capitalize on this storage technique. A major hub of pipelines existed near Suffield (South-central AB) and Alberta Energy Co. (now Encana) developed a major storage facility. Originally, this was a natural reservoir.
    - With storage, the suppliers could also benefit economically. They could hold gas until prices were high, and could accumulate a supply cushion to ensure a continued supply of gas in their guaranteed gas supply contracts
        - Current storage includes a massive storage facility at the pipeline hub in the Suffield resevoir (southern Alberta)

Aliso Canyon Leak in California has been leaking since Oct 23. Leaking 1200 tonnes of greenhouse gasses per day → equivalent to California's daily methane emissions

Legal Implications of Gas Storage

- What happens when a gas owner, who previously had possession and control of the gas, re-injects the gas back into an underground reservoir?
    - There are two American authorities (Hammonds and Lone Star), which are not the law, but help us outline the dispute and provide us with the two competing arguments

Hammonds v. Central Kentucky NG Co. (1934) Kentucky CA (**held that reinjection loses ownership rights...OVERTURNED by *Lonestar* → on *ferae naturae* theory**)
Facts: CKN Gas Co. exhausted the gas reserves under the land they were leasing. However, they decided to use the now vacant reservoir as a gas storage facility. They re-injected gas into the reservoir, some of which migrated to the neighboring property. Kentucky's problem was that Ms. Hammonds owned 53 acres in fee simple in the middle of the reservoir. She complained that Kentucky was trespassing by putting their NG under her property. Ms. Hammonds then sued GasCo in trespass asserting that GasCo could not store its gas under her land without her permission (and more importantly – compensation).
Issue: Does storage of NG by GasCo in the above method constitute a trespass?
Held: No. Ownership is lost upon re-injection, and therefore, there can be no trespass since the gas does not belong to anyone.
Reasons:

- **Wild animal theory:** Ownership of wild animals only exists while the animal is captured. The court held that this theory applies to minerals. When you put NG back into the reservoir, you are putting it back into the wild.
    - The result of this is that Ms. Hammonds can produce NG. Therefore, although the company does not have to get her permission for storage, they will have to buy her out to prevent her from taking the NG
- Therefore, you lose ownership rights by storing your gas. However, we have already found that the rule of capture is not the proper ownership theory to be applied in oil and gas law.
- However, this case stood for 30 years until *LoneStar*

Lonestar Oil and Gas Co. v. Murchison (1962) Texas Court (overturns Hammonds, now reinjection does not lose ownership rights)
Facts: Court referred to the re-injected gas as "extraneous gas." In this case, the extraneous gas of GasCo had migrated into M's reservoir, and M had produced this gas (under a lease to another GasCo). This seemed to be M's natural right in light of the decision in *Hammonds*. Party was drawing NG from a reservoir that was not theirs
Issue: Re-examination of the issue from *Hammonds* – is ownership of gas rights lost upon re-injection of the gas into an empty reservoir?
Held: No, GasCo did not lose ownership rights upon reinjection (overturns *Hammonds*); but there is a trespass. The court said that for gas storage to work, we need to realize that the company who stores it still owns it.
Reasons:

- Wild animal / rule of capture theory is inappropriate for gas (same principle applied in LMM). Gas is an inanimate, diminishing, non-reproductive substance. It is not wandering/fugitive. Instead, it collects in reservoir traps where they invariably remain until interfered with by man
- Gas that has been produced is personal property. Loss of ownership of gas would result only from abandonment, and abandonment hinges on intention
    - Here, there was no intention to abandon the gas when it was re-injected into the reservoir

NOTE: Since GasCo now owns the gas, gas that migrates into M's reservoir would be a trespass. Therefore, GasCo must settle some agreement with M (likely a lease of the entire reservoir)

- This part makes this case the opposite of Kentucky, but the practical result is the same
- What if there is any native gas in M's reservoir upon execution of the storage K?
- When GasCo negotiates the storage agreement with M, they will have to take into account any native gas

Rule from Lonestar: Gas which someone has brought out of the ground belongs to that person, and, subject to abandonment, continues to belong to that person even if it injected into the ground as part of a storage program. In other words, you need to ensure that you have the right to store the gas from the correct people.

Legislative Response in AB

- Storage rights will depend on what substances are in the reservoir
- MM owner: A mine is defined in the CL as a space around a mineral. But what if there are no minerals? At CL, if there was a cave that did not contain a "mineral", it belonged to the surface owner
- **Key Point:** Owning M&M does not give you the rights to everything under the surface of the land

New AB legislation which quieted title with respect to underground formations (1994):

- **s. 57 MMA:** For the first time the AB legislature passed legislation dealing with underground storage rights; they set out superficially simple rules
    - (1)(a) where a person owns title to both P and NG that person is the owner of storage rights
    - (1)(b) where one person (like *Borys*) owns the P and another owns the NG they are the co-owners of the storage space
        - This is the split title situation (**tenants in common**)
    - (2) **non-PNG subsurface interests**: Where storage facility is created by the recovery of a mineral, then the owner of that mineral owns the storage space
        - "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 wrt to that subsurface cavern to the extent that it lies with the land"

What about a person who owns a naturally occurring cave?

- Legislation does NOT remove surface owner's rights.
    - In order for legislation to take away property rights, it must do so expressly, not impliedly. Furthermore, there is a presumptive right to compensation upon removal of a property right. Also, legislation is not retroactive unless it expressly indicates so
        - Recall CBM line from BC. CBG must be considered to be and always to have been NG. The AB legislation fails to say. However, the draft did contain language to the effect of the BC legislation
            - NOTE: Presumptions above are from *Edward v. Simms*
    - The cave owner could make a convincing CL point:
        - *Edward v. Simms* presumptions at CL re: expropriation and compensation
        - If you were a careful solicitor, because of the above you will want to get rights from the surface owner

What about limestone (which is defined as a mineral)?

- Limestone causes caves, but that does not end the discussion because the Act speaks of the *recovery* of a mineral
- So in AB, the surface owner would own the cave if the limestone owner did not recover the limestone to create the cave. Why? Because of our three presumptions above. If the limestone owner created the storage facility through the recovery of limestone, then that person would own the storage rights to the cave.

- In jurisdictions without the MMA, limestone is not considered a mineral and without more the surface owner will own the storage rights to a cave beneath his property. Why? *Edward v. Simms*.

(9) CARBON CAPTURE AND STORAGE

What is CSS?

- CCS is a process that captures carbon dioxide emissions from large industrial emitters and stores them in geological formations
- in 2008, the Gov't of AB committed $2 billion to large scale CCS projects in AB
- Gov't owns it all.
- Under Kyoto, Canada chose to take advantage of clean development and joint implementation programs to reduce carbon emissions (allowed us to credit another jurisdiction's reductions to our own if we helped them accomplish them)

Carbon Capture And Storage Statutes Amendment Act, 2010

- **s. 15.1(1):** No grant ever given by the crown of Alberta does or has conveyed title to the "pore space" occupied or formerly occupied by minerals or water below the surface of the land
    - c) This exception is deemed to apply to any grant of land made under the *Land Titles Act*
    - Pore space is defined in the regulations.
- (4) This does not amount to an expropriation by the crown
- (5) No person shall claim a right from the crown for this pore space (affirms that this is not an expropriation, but no one is able to challenge the crown's absolute title, the crown has ALWAYS owned the pore space. This also shows the Crown can remove property rights without compensation.)
- The CCS is retroactive and suppresses competing claims. The CCS specifically targets those who have natural gas storage rights as they are the only other likely competitor, and the act clearly lays out who would win in a dispute between the two (the Crown).

Four key issues

- The Gas storage act of 1994
- gas storage disputes
- Carbon Capture and Storage Statutes Amendments Act, 2010
- Potential conflicts arising from the 2010 Carbon Capture and Storage Act

***Gas Storage Act* of 1994**

- attempted to clarify pore space ownership
    - amendments to the Mines and Mineral Act
    - storage rights are held by the PNG rights owners, rather than the surface owners
    - storage rights in the split title circumstances are co-owned
    - special rule for "subsurface caverns"

***Gas Storage Act* of 1994 - Concerns**

- Expropriation of the surface owner's common law ownership of caverns
- no express provision that eliminates the claims of the surface owner
- need for permission of the surface owner, as well as M&M owner
- This was deceptively simple in its declaration of rights
- One other potential claimant not mentioned in the act: owner of a naturally occurring cave. They may have the right to store gas.
- Minerals were defined through the common law. Mines were seen as merely the container of the minerals.

How does the Crown fit into all of this?

- What space not covered by the legislation may the surface owner still have ownership over? Caves are not addressed in the legislation. Note that these are not mines, and as such would fall to the surface owner.
- Crown disposes of storage rights that it owns under the terms of the Mines and Minerals Act
- gives the Crown flexibility to negotiate special gas storage agreements
- use of unitization agreements

Crown Ownership RE: Pore Space

Long term liability

- province accepts long term liability for injected carbon dioxide; CCS operator only responsible until closure certificate
- AB Gov't is obligated to indemnify the operator
- issuance of "closure certificates' upon completion of the CCS project

The "Disappearing Corporation"

- Province may assume ownership of captured Co2 where the lessee "ceases to exist"
- ERCB may deem a lessee to be a "defaulting working interest participant"
- Province may make payment to a person in respect of a defaulting working interest participant's share of suspension, abandonment or reclamation costs

Stewardship fund

- CCS operators will pay into a post-closure stewardship fund
- fund will be managed by the AB Gov't
- used for ongoing monitoring costs and any remedial work required following the issuance of a closure certificate
- third party liability indemnity claims not covered by the Post-Closure Stewardship fund

Conflicts arising from the 2010 CCS Legislation

- Conflicts between the 1994 Gas Storage Legislation and the 2010 legislation
    - under the 1994 act ppl don't lose there right generally, but in the event of **competition** between carbon capture and natural gas storage, then the Crown wins

(10) INTERESTS UNDER THE LEASE

Berkheiser v. Berkheiser (1957) [LOOK TO THE TERMS OF THE INSTRUMENT; DEPENDING ON LANGUAGE, COULD BE TITLE IN FEE OR PROFIT A PRENDRE

Facts: In the last few years of the testator, she did a few things. In 1947, she left her land in her will to the appellant. In 1951, she leased the petroleum and NG in the same lands. She died in 1953. The appellant claims that he is entitled to the fruits of the NG lease, while the respondent claims it should go to the residual beneficiaries.

Issue: Who owns the MM?

Held: The fruits of the NG lease belong to the residual beneficiaries.

- **The title in PNG remains with the land owner, subject to rights of the "lessee" to search for & win named substances**

Reasons:

- Under a normal lease the lessee returns the property, but again, this is not a lease. This is also not an outright sale, as there is a right of reverter at the end of the lease .
    - The object of a lease is to give someone the temporary rights of the property, but their obligation at the end of the lease is to return the property in the same condition that the property was in when the lease was entered into
    - The object of a PNG lease is to return as little as possible at the end of the lease. This does not fit into any category perfectly, but is analogous to a profit a prendre (ie. an interest in the land) like the right to hunt for fish or fowl on someone's land.
    - **The provisions of this lease were inconsistent with a grant in fee**
        - More akin to a profit a prendre for an uncertain term

Fallout: *Land Titles Act* - "for the purpose of the Land Titles Act, a PNG lease is a lease."

(11) BLOW-OUTS

Definition: The uncontrolled flow of gas, oil or other fluids from a well which occurs when the pressure within the well exceeds the pressure in the borehole applied to it by the column of drilling fluid. Also results in the release of toxic sour gas (H2S)

Occurence: With better technology (pressure control systems), there is generally a decrease in blow-outs, but we have seen some recently in the Leduc oilfield, Wabamun and Enoch

The Law: There is no legislation in AB that deals with one's rights and remedies upon a blowout, and there has yet to be a CDN case on the subject. Therefore, we must look to American law on the subject to provide a framework (not binding)
→ the case law here is illuminative, but is certainly not binding

Eliff v. Texon Drilling (1948) Texas [UNDER TEXAS THEORY OF OWNERSHIP, ENTITLED TO DAMAGES IN NEGLIGENCE]
Facts: The plaintiffs owned a mineral estate and entered into an OG lease of the mineral estate with the lessee. A blowout occurred on the adjacent property that overlaid the same reservoir of the P's. The well burned for two years and a large quantity of OG was released and dissipated. In addition to the enormous loss of OG, the P's water wells, livestock and land were damaged.
Issue: Does the law of capture absolve TDC from liability for its negligent destruction of the plaintiff's OG, recognizing that substantially all of the wastage occurred through the opening on TDC's leased land?

- **Plaintiff's Argument:** TDC caused the blowout through their negligence, which wasted the OG that they would have otherwise recovered. They also had a royalty interest in the land, and now they are losing it.
- **Defendant's Argument:** Analogy to a race -- they claimed they were both entitled to take from the pool, but they just did so more rapidly. They shouldn't be liable because the plaintiffs did not obtain ownership of the OG until possession.

Held: For the plaintiffs. No right to negligent waste/destruction of PNG. Damages = trespass damages (different in value of land)
Reasons: Texas is an absolute ownership state where a landowner is regarded as having absolute title to the oil and gas beneath his land (*in situ* ownership) There are only two limitations on OG ownership in Texas:

1 Capture by your neighbor
2 Limitation by state policy (meaning regulatory) power

These rules are designed to afford each owner (a) a reasonable opportunity to produce his proportionate part of the oil and gas from the entire pool and (b) to prevent operating practices injurious to the common reservoir. → LANDOWNER HAS RIGHT TO DEVELOP THEIR OWN PROPERTY

- No Right to negligently waste/destroy PNG (a duty owed to *the reservoir*)
- Reasonable/necessary waste incidental to production = allowable; no liability.

NOTE: The above describes AB law pretty well. Although *Anderson v. Amoco* argues that AB law is closer to Louisiana, DP cannot find a difference between Texas and AB law.

- Incorrect Damages. Should NOT have been trespass
    - Should've been compensated for the taking of their property interest.
    - Likely insufficient for a conversion interest; PNG in storage tanks on land would likely be different!

Summary of damages: Trespass is calculated based on the difference in the value of the land (limiting); **Negligence damages are based on the value of the loss occurred (ie. wasted OG and unrealized royalties);** Conversion requires possession and is usually calculated at the time of conversion, although there is authority that in the case of assets with fluctuating value (ie. shares or OG) then, subject to a mitigate or litigate rule, you can obtain the highest value for the converted property between the time of conversion and the time the property is returned (judgment).

Why is there no blowout litigation in Alberta?

(1) Early Regulatory intervention (ie. *Atlantic Claims Act*); and

- AB had a monstrous blowout in 1948
    - Atlantic Oil Co. was described as a non-descript semi-bankrupt oil company known for cutting corners on safety
        - McMahon from McMahon stadium
    - As a practice, they were not putting casing in the well, when the blowout occurred oil gushed for six months and then burned for six months
- ERCB's predecessor steps in and limits production on other parts of the land.
- ERCB took control over the well, and placed IO in charge of stemming the flow. Could not stop the flow.
    - Trivia: Had the effect of drawing investment to AB
        - Legislature enacted a one time Act – the Atlantic Claims Act – and created a trust fund to deal with loss related to the blowout. The TF, with money received from recovered oil, was used to pay out claims.
        - All claims must proceed through the TF
- How are co-owners compensated?
    - s. 3: Board can pay out money for any settlements

- s. 4: Deemed the Atlantic well to have overproduced by 565K barrels. To make up for this, ERCB placed restrictions on production and drilling
- Slowed Atlantic's production from other wells to an amount not to exceed 2/3 normal production, and prevented Atlantic from drilling other wells on its property until such time that other landowners have been compensated
    - This attempts to redress the balance by allowing others to take a greater share from the common reservoirs.
- s. 5: No person shall commence an action against Atlantic or ERCB unless they have obtained the consent from the AG

DP: This case/Act is interesting because it begins to tell us why we do not see litigation – consequences of a blowout are almost immediately taken over by the Conservation Board

(2) Industry and regulator are averse to litigation

- ERCB publishes a document called "Interim Guideline for Resident Compensation During Sour Gas Well Blowout Emergencies." → THREE TIERS APPROACH TO DAMAGES AND ENTITLEMENTS
- Petroleum producers helped draft this doc.
    - 2.0: "it is the industry's position that all persons who have suffered damage as a direct result of an industry operation should be fairly compensated by the operating company"
        - Industry is committed to a three tiered approach wrt compensation
            - (1) Immediate out of pocket expenses
                - hotels, meals, etc.
            - (2) Costs directly related to the release of sour gas and that emerge shortly after the blowout
                - death of livestock, damage to buildings, etc.
            - (3) those associated with longer term impacts where cause and effect are unclear
                - not covered by the policy
    - "It is generally in the interests of all parties that serious effort be made to resolve disputes by negotiation prior to proceeding with any of the other dispute resolution mechanisms described below"
        - -s. 6: Options for resolving disputes
            - negotiation
            - mediation
            - arbitration
            - litigation
- DP: The manual greatly discourages litigation and the use of lawyers. This is outrageous that the Board puts this out as an informational letter
    - Note: Oil industry is ruthless in litigation, but it is funny that the oil industry discourages the use of lawyers here. They probably do not want information released via examination for discovery.
- DP: Another point is that we did not have class action legislation until 2005.
    - Why? It was opposed by the OG industry

ECRB Investigation Report - Penn West Petroleum Ltd. (Well Blowout)

- Penn West well blew out near swan hills
- This was deemed a level 2 emergency by the ECRB
    - C02, water and diesel were pumped into the well which eventually compromised the well casing
    - The top packer failing was determined to be the cause of the blowout,
        - this was not repaired by Pennwest and a BOP could not stop the blowout.

(12) GEOPHYSICAL EXPLORATION

How does it work? An energy pulse is transmitted into the ground using a mechanical device such as a vibrator truck or explosive energy. Ex. A stick of dynamite is sent down a hole, and sound reflects back at different rates from different layers of rock (ie. fast from limestone, slow from oil pools) → **very similar to echolocation**

- Environmental Concerns: Large paths used to be cut through wooded areas to conduct seismic exploration, now low impact seismic exploration done with much smaller (and non-straight) paths has reduced the environmental footprint.
- Usually done by blasting in intervals along a seismic line
- 2D is traditiona; -- gives slices of data that we compile

Issues:
(1) Whose permission is required at common law in order to conduct this kind of exploration?
(2) What are the torts and remedies that result if an oil company fails to seek permission for exploration?

Phillips Petroleum Co. v. Elliot F. Cowden (1957) USCA [WITHOUT PERMISSION TO EXPLORE, DAMAGES IN TRESPASS ARE LIMITED TO THE REASONABLE MARKET VALUE OF THE USE THE SURVEYOR MADE OF THE MINERAL OWNER'S PROPERTY → UNJUST ENRICHMENT → CAN'T CLAIM FOR INFORMATION RETRIEVED BY EXTRAPOLATION]
Facts: An oil company entered onto land to conduct geophysical exploration. They received permission from the surface owner to do so, but the surface owner did not own the M&M beneath his land. The M&M owner (Cowden) did not provide permission, and they claimed trespass.
Issue: Who can grant the right to explore the mineral estate?
Held: The right of exploration is normally attributed to the MM owner. Therefore, permission must be obtained from MM owner, and the surface owner's permission is irrelevant.
REASONS:

- Trespass is a direct interference with one's property. It is an action that does not require any damage.
    - The court called this a geophysical trespass, on the basis that the shockwaves shook up the MM a bit.
    - The damages were calculated via difference in value of the MM before and after the trespass
        - (usually it would be nothing as the minerals would just be rattled)
- Original estate owners granted "surface only" to surface owner,
    - Remainder Estate owners need not reserve an "exclusive" right to explore b/c didn't grant it at all

Waiver of Tort: Rather than sue for trespass, seek recovery of the benefits received by the wrongdoer (ie. the reasonable market value of the use and occupation of the property)

- The Texas court used this as a basis to award damages, instead of awarding damages based on trespass (since they would lead to practically nothing)
- This could be applied in Canada in a similar situation, but the MM owner could only sue the geophysical trespasser with respect to the trespass (NOT for conversion of the information or the right to sell it)

Surface Owner Denial?

- surface rights board has no power
- companies must go to the county & pay for an adjacent road allowance and set off the seismic charges there
    - Theoretically, this could still be considered a trespass as the vibrations could still interfere with the MM of the original land. The further away the shothole is from the original land, the more likely it will be classified as a nuisance rather than a trespass
    - However, *Phillips v. California* held that vibrations from seismic exploration DO NOT constitute a trespass
        - Comes down to the directness of entry

***Mines & Minerals Act*, Exploration Regulation 284/2006**
8(1): No person shall conduct exploration: (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

- Do they mean surface owner or MM owner here? Unclear. If it means surface owner (most likely), then it reverses the CL principle

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

- This is likely referring to the requirement of permission from the MM owner

Phillips v. California Standard (ABSC) [VIBRATIONS TRANSMITTED BY SURVEYOR ON ADJOINDING PROPERTY AREN'T TRESPASS, BUT CAN BE NUISANCE → DON'T TECHNICALLY NEED DAMAGES, BUT COURT MIGHT JUST REFUSE]
Facts: An oil company conducted seismic exploration on a neighboring property. The vibrations resulting from the shockwaves caused the contamination of P's well.

Issue: Why couldn't the P's recover for the injury that occurred in just the same way that the P's in Phillips v. Cowden did?
HELD: Seismic Vibrations = Nuisance, not trespass
Analysis: In Canada trespass involves a physical entry on the property of another. The vibrations transmitted to land do not in law constitute a trespass. However, this is a nuisance, ie. an unreasonable use of property so as to interfere with the neighbor's use of the property. Unlike trespass, in nuisance you have to prove damages.

- Damages = $1,500 for damages to well.

Wassan v. California Std. [**EXEMPLARY DAMAGES ARE APPROPRIATE WHERE THE DEFENDANT DELIBERATELY TRESPASSES**
Facts: Oil Co. tries to get permission from the owner of the land to cut a survey line. Asked his wife, she said talk to husband the land owner. The oil company said they do not require their permission at CL, and if they are held liable for damages, it would be cheaper to be sued because damages for trespass are low (around $1000 in this case) → BELIEVED BENEFIT WOULD OUTWEIGH PENALTY
Held: Punitive damages were awarded to deter this type of behaviour

- Must remain in accordance with principles of exemplary damages (restraint should be exercised)

REASONS: Purposefully did not seek consent based on cost of action vs. damages for trespass. Punitive damages.

The Value of 3D Seismic in Today's Environment
2D Seismic: Performed using straight lines of receivers across the surface of the earth. This produces a cross-section image of the reservoir, and requires the exploration operations to take place on the land being explored
3D Seismic: Uses many lines of receivers, and by sequentially recording a group of shots lying between two receiver lines, a cubic image can be produced. Does not require the exploration operations to take place upon the land being explored

- **Advantages:**
  - Enables you to see the block/cube of earth beneath the surface and enables you to plot not only where oil is likely to be found, but also the contours of the reservoir
  - Recordings are made over a large area, and at some distance from the area that you wish to explore. The information is gathered from alongside the structure (rectilinear)
- **Disadvantage:** Expensive

Is a 3D seismic operation considered a trespass?

- Since 3D seismic does not require the exploration activities to take place on the land being explored, there is no direct physical entry that takes place, and therefore trespass is not available
- The vibrations are also minimal, and therefore nuisance is likely not available (because it requires damages)
- There may be some recourse available under privacy law (ie. *Victoria Park Raceway* scenario, looking into a neighbour's land), but this is a very difficult argument to make.

Chapter 3: Acquisition and Conveyancing of Interests in Oil and Gas

(1) WHEN DOES A LEASE MEAN A PNG LEASE?

Introduction

- Remember, PNG raises the same conveyancing issues as any other type of real property (*LMM*)
- Mineral owner is often disadvantaged re sophisticated O&G companies

Conveyancing Problems in OG

1 Unusual statutory provisions unique to OG law
2 How to deal with MM that are held by estates
3 OG and the Rule Against Perpetuities

***Common Parties Contracts and Conveyances Act* (ultimately brought into LOPA)**

- Unique to AB and was inspired by the OG industry
- CL: A cannot contract w/ AB
    - This Act *validates* a K between A & AB
- Often see A as one party and A + B as the other party, can have other variants of this, ie. A+B and A+B+C
    - Therefore, A is part of both sides of the K, and cannot sue himself
    - How does this happen? Go back to Unitization
        - All interest holders in DSU's over a field combine to form a unit
            - Largest landholder is often appointed as *operator*
                - EX: a K between the operator and the operator's interests outside the unit
            - Says that operator is contracting as agent for the unit

Law of Property Act

- **Part 2:** Common Parties Contracts and Conveyances
    - s. 10 – Common parties to a K
        - (1) Ks are valid and enforceable NWST
            - (a) A contracts with A/B
            - (b) A/B contracts with A/C
            - (c) A/B contract with A
        - (2) A K is valid and enforceable NWST that <u>a person by that K allegedly contracts with that person alone</u>, **<u>if</u>** that person, in one of his capacities to that contract, is <u>acting as agent</u> for some other person
        - (3) This section applies to contracts for conveyancing of an interest in real/personal property.
- **Part 7:** Mineral Titles Clarification
    - s. 56 – Mineral declaration. This section sets up a lengthy list as to what is a "mineral", and therefore alleviates the uncertainty associated with the CL definition; note that a "mine" at CL is a space around a mineral, so the list of minerals also helps us to determine what a mine is
      -Limestone is a mineral. This helps us with pore space. So if you are concerned with permissions for gas storage, this gives us a leg up on the CL.
      -ie. caves. Problem is that limestone is regarded as a mineral in AB, although it is not at common law.
    - s. 57 – clay, marl, sand and gravel are not minerals and belong to the surface owner.
    - s. 63 – Equitable interests in land.
        - Not an interest in land at CL, but due to this Act Right of 1st Refusal = interst in land
            - registrable by caveat.

<u>Mines and Minerals Held by an Estate</u>

Devolution of Real Property Act: Lease > 1 year by executor (on behalf of beneficiaries) requires court approval.

- s. 14: The personal representative may, from time to time, subject to the provisions of any will affecting the property, do any one or more of the following
    - (a) lease the real property or a part of it for a term of <u>not more than 1 year</u>
    - (b) lease the real property or a part of it, with the <u>approval of the court</u> for a <u>longer term</u>

- **Key Point:** Oil Co. can get a lease from an executor, although in most situations it will likely require court approval.

Minor's Property Act

- s. 2: Minor's estate: Before a minor's interest in any real estate can be subject to a conveyance, the court must be convinced that:
    - It is necessary or proper for the maintenance or education of the minor, OR
    - The conveyance advances the minor's interests

Devolution of Real Property

- Arises out of the fact that almost every basic prairie will starts off by leaving everything to the surviving spouse in the form of a life estate, with the balance to the kids
    - Problem: Often find MM held in a life tenancy, meaning that there is also a remainder interest
- PNG lease is a lease for the purpose of the DRPA (now: Law of Property Act) (*Hayes v Mayhood*)
    - **Berkheiser: says not a true lease, but** actually a profit a prendre or an irrevocable licence to seek for and win the substances identified in the lease

Hayes v. Mayhood (SCC) [USED SEPARATE LEGISLATION TO DEEM A MINERAL LEASE A LEASE → MAY HAVE GONE TOO FAR; CONTRARY TO *BERKHEISER*] → pro tip: always ask if the legislation includes the PNG lease

Facts: The will devolved a ½ interest to one person, a ¼ interest to another person, and split up ¼ amongst 8 others. The executrix entered into an OG lease of MM owned by the estate which would ultimately split according to the fractions above. Here, one of the nephews objected on the grounds that the MM cannot be leased without court approval, on the basis that this is not a lease. This is a characterization issue.

- When an estate owns property, it can lease the property w/ approval of the court.
- **Recall:** Berkheiser says that a PNG **lease is not a lease (it is a grant of a profit en prendre).**
- **Recall:** DRPA requires court approval for > 1 year.

Issue: Is a PNG lease a "lease" under s. 14 of the DRPA (now LOPA) such that the court has the ability to approve the conveyance to the Oil Co?

Held: Yes

Analysis: The Devolution Act must define a lease as it is defined in LTA. An OG lease is a lease for the purposes of the LTA, because the Devolution Act is dealing with the same type of instrument as the LTA, it will be characterized as a lease for the Devolution Act. The problem is that the LTA says that an OG lease is to be characterized as a lease for the purposes of the LTA

- Argument: The former case that said it was a lease under the LTA, it applies here as well.
- **But, this is really stressing the logic. Because what other pieces of legislation are implied????**

ALWAYS THINK: does this legislation include an OIL & GAS LEASE?

- Lots of legislation says "for the purposes of this act, lease does not include PNG"

DP: Difficulty is that lots of other Acts also refer to a lease, so could you make the same argument?

- Implication 1: When AB amended the LTA to include the an OG lease as a registrable lease, that they amended all statutes that use the term "lease". Now, you have to ask yourself if this will refer to an OG lease in every other Act (ex. the Perpetuities Act)
- Implication 2: In provinces that have a DRPA, but do not have similar wording in their LTA, there cannot be an OG lease for a term of more than one year
    - AB was alive to the issue and when they enacted the LTA, they included a qualification indicating that "this Act does not apply to minerals held separately from the surface of the land or any dealings with minerals

(2) LIFE TENANTS

Lease of Mines & Minerals in which there is a life estate.

- CLASSIC PRAIRIE WILL:
  - Testator leaves farm/house to surviving spouse for duration of life
  - On death of the spouse, it goes to the kids.

Issue: A life estate does not include a full bundle of rights.

- A life tenant is generally entitled to full use and enjoyment of his land, subject to limitations of wastage (which is based on the principle that the testator has expressed an interest that the land be preserved for the remainderman)
- The life tenant is entitled to income from the estate
  - Includes: Interest on the amount of the profits from PNG lease (profits go to remainderman) (***Re Moffat Estate***)
- The remainderman is entitled to everything remaining after the life tenant's interest ends (ie. the surplus capital of the estate)

Re Moffat Estate [WHEN DEALING WITH A LIFE ESTATE WITH AN INTEREST OVER, REMAINDERER HAS INTEREST IN THE MINERAL ESTATE → BUT LT NEEDS TO CONSENT TO DEVELOPMENT; IF THE ESTATE WAS SUBJECT TO A LEASE, THAT GOES TO LT]

Facts: The testator left the estate to his W, with a remainder to his Children A & B. The executors (child A & Spouse) decided to lease the MM beneath the land. Ignores the interest of Child B. The lease was successful in that it resulted in 3 types of payments: Cash bonus, delay rental payments (for the time the land was used without a well being drilled), and royalties when a producing well was drilled.

Issue: How should the income from the lease be divided?

Held: The CORPUS of the estate is the Oil, which is being sold. All the money made from that sale should be held in trust for the remainder person; the interest (the product of the Corpus) is the property of the life tenant.

Reasons:

- An oil and gas lease presents problems because the substance of the estate is being produced, and therefore is not being preserved for the remainderman
- LIFE TENANTS: can enjoy the proceeds of the estate, but must pass on the body of the estate to remainder person
- The CORPUS of the estate is the Oil, which is being sold. All the money made from that sale should be put in a fund for the remainder person, the interest (the product of the estate) is the property of the life tenant.
- The remaindermen consented to the OG lease, so who gets the payments? Two possibilities
  - **(1)** If the MM were leased prior to the testator's death, the testator's intention was that the benefits of the lease should flow to the life tenant
    - NOTE: The life tenant could not drill another well or enter into another lease – that would be wastage
  - **(2)** If the MM were NOT leased prior to the death of the testator, then the testator's intention was that the property be preserved for the remainderman
    - Therefore, the remainderman is entitled to the payments from the lease, but is not entitled to possession until the LT dies, and to allow the remainderman to execute a PNG lease prior to this event would destroy the LT's property
  - **Practically,** if you are leasing MM when there is a life estate you need consent from both the life tenant and the remaindermen. Presumably you want everyone to agree on how to deal with the proceeds of the lease to avoid the issues in this case.

Agreements for Sale:

- With real estate transactions, the vendor retains title, and the purchaser acquires title once the agreement for sale is performed.
- **Problem:** If you want to lease those MM, from whom do you lease them?
  - The oil company does not want to lease from the vendor, because if the purchaser performs, then the vendor no longer has title
  - Also, leasing from the purchaser is not a good idea because if they do not complete the agreement for sale, the oil company is in trouble
  - **Practically, you need consent of both the vendor and the purchaser + postponement.**
    - The Oil Co. will get lease from Vendor first, will then approach the purchaser to gain consent.
    - Because the purchaser has a registered agreement for sale, the Oil Co. must get the purchaser to agree to a postponement (lease will rank ahead of P's title once acquired)

        - Vendor's title subject to: 1) Agreement for sale 2) O&G lease, 3) Postponement of interest
            - Effectively, the title is then subject to 1) O&G; 2) Agreement for sale

(3) PERPETUITIES

- **Purpose of RAP**: Avoid the fettering of real property with future interests dependent upon contingencies that are unduly remote and isolate or exclude the property from commerce and development
- **CL Rule:** No future interest is good, unless it must vest, if at all, not later than 21 years after some life in being at the creation of the interest
- Perpetuities Problems MAY arise in an oil gas context when:
    - 1) A contract provides that an interest in real property vests after a P&G lease
    - 2) An option to renew the lease engages (i.e. a thereafter clause that states that the lease lasts for the primary term and as long as MM are still produced)
- This raises the issue of perpetuities, which are triggered by contingency and intended to prevent remoteness
- The duration itself it not the issue, but whether option to renew = potential vesting after perpetuities period
- Common Law apples to O&G lease made pre-perpetuities act (1973ish): which is a lot
- In an Energy company, you may be asked to draft an instrument for non-AB provs OR USA.
- *Canadian Long Island Petroleums Ltd*: purpose of RAP is to prevent exclusion of land from commerce and development
- **Perpetuities issues often pop up in option for renewal at the conclusion of the primary term of a lease. Also in top leases**
        - How to protect top leases? File a caveat

Perpetuities Act

- **Possibility of Vesting Beyond Period (s. 3)**
    - No disposition creating a contingent interest in real or personal property shall be treated as or declared to be void as violating the rule against perpetuities by reason only of the fact that there is a possibility of the interest vesting beyond the perpetuity period
- **Presumption of validity "wait and see" (s. 4)**
    - Every contingent interest in real or personal property that is capable of vesting within or beyond the perpetuity period is presumptively valid until actual events establish that the interest is incapable of vesting within the perpetuity period (then it is void) but if it is incapable of vesting outside the perpetuity period, it will be deemed valid.
- **Options to Acquire a Reversionary Interest (s.17)**
    - (1) The RAP does not apply to an option to acquire for valuable consideration an interest reversionary on the term of a lease or renewal of a lease, whether the lease or renewal is of real or personal property, if
        - (a) the option is exercisable only by the lessee or the lessee's successor in title, AND
        - (b) it ceases to be exercisable at or before the expiration of one year following the determination of the lease or renewal
    - (2) Subsection (1) applies to an agreement for a lease as it applies to a lease, and lessee shall be construed accordingly
    - (3) Subsection (1) applies to a right of first refusal ROFR or pre-emption as it applies to an option
    - **(4) The RAP does not apply to options to renew a lease of real or personal property**

Key Point: This provision states that as long as the original lessee continues to be the party with the reversionary interest in a lease, and according to the lease they must exericse that interest within 1 year, then a reversionary interest does not offend RAP

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

The CL Exception: At common law (and now in the Perpetuities Act in AB), **an option to renew a true lease is EXEMPT from RAP.**

- If rationale re:RAP = prevent an unascertained vesting of an interest,
- THEN option to renew = know when and with whom the interest will vest.
    - no issue of remote vesting.
- This DOES NOT apply to oil and gas leases, as they are profit a prendres
    - With a true lease, a lessee exercising his option to renew stays in possession of the land,
    - oil and gas lease (ie. a profit a prendre) does not have possession at all
    -

Canadian Export Gas & Oil (CEG) v. Flegal (1978) Alta SC [LEASE EXCEPTION TO RAP DOESN'T APPLY IN THE CASE OF O&G LEASES → MIGHT BE ABLE TO SAVE THE EXCEPTION IF WE CAN CHARACTERIZE IT AS A TRUE LEASE]

Facts: The primary term was for 10 years, and at the end of the term, CEG (OilCo/lessee) had the option to renew the lease for another 10 years. The option to renew would create a new lease with the exact same terms, including another option to renew. The lessor is arguing that the right of renewal is ineffective because it violates the RAP. The lessee is arguing that an option to renew a lease is an exception to the RAP and that therefore this option to renew is valid.

Issue: Does this lease violate the RAP?

Held: Yes. The CL exception whereby an option to renew a lease does not apply to an OG lease, since an OG lease is not really a lease, it is a profit a prendre. Therefore, the lease exception to RAP does not apply to OG leases.

Reasons: This was a perpetual right of renewal. The oil and gas lease could have continued indefinitely. The purpose of the RAP is to avoid the sterilization of land, and that was the intention of this lease. Therefore, RAP was violated.

- Could have included a "Life in Being" clause: "The option must be exercised before the end of the period ending at the expiry of 21 years from the death of the last survivor of all the lineal descendants of [his late Majesty King George V or some other British monarch] who have been born on the date of this agreement."
- Tried to argue that the first option to renew would occur w/in 21 yrs, BUT remember RAP = matter of *possible* vesting
    - ALSO: would involve reading down the K to interpret it to allow 1 renewal and not future renewals.
        - Not w/in Court's power to read down a K
- ALSO: If this lease were **post-1973**, perpetuities act would allow **wait & see for 80 yrs** as a commercial transaction.

Is CEG's interest a lease?

- Remember, the CL exception only applies to a lease
- PNG lease = for LTA purpose, but not for all purposes, especially for the application of a CL rule (***Flagal***)
    - *Hayes* is distinguishable from prior and subsequent decisions b/c looking at CL not a particular Act

Court said the reasoning for the lease exception has been forgotten and they saw no reason to extend it in this case

Is perpetual renewal provision subject to RAP?

- There are no authorities for the idea that perpetual renewals of a profit a prendre are an exception to the RAP
- Option to renew - still know where the estate = in the hands of the lessee, and if not renewed, will revert to the lessor
- **Key Difference:** To permit perpetual renewal of a lease stimulates development, while renewal of this profit, which only becomes necessary if there is no development, encourages sterilization
    - "A right to renew a *profit a prendre* is not a present vested interest to which the rule does not apply"
    - NOTE: This was a trial decision in AB. Contrary to this decision, you could make a pretty good argument that an option to renew in a profit a prendre falls under the exception.

Exam Question

- In this case, the "wait and see" provision, and s. 18 which extends the perpetuity period to 80 years had not yet been enacted.
- If Flegal were to happen today, what argument could be made to avoid the application of RAP, and guarantee a mineral rights lessee the continuation of the lease?
    - *Hayes v. Mayhood:* Perpetuity rules deal with real property. The word "lease" in the CL rule and s.17 includes an oil and gas lease, and the LTA defines a lease as for the purposes of that Act. According to *Hayes* if an O&G lease is a lease for the purposes of the LTA, and the DORPA, then it is also a lease for the purposes of perpetuities legislation.
- When we see the word "lease" there is a modest alarm bell because of Hayes v. Mayhood. So, if you are desperate, bring this up.

PanCanadian Petroleum Ltd. v. Husky (1994) ABQB [A PROVISION ALLOWING PERPETUAL RENEWABILITY WITHOUT PRODUCTION VIOLATES RAP]

Facts: PCP (the lessor) is the successor to railway lands. They leased 1.1 million acres of land to Husky (lessee) using **2 leases** with a primary term of 25 years, and so long thereafter as the leased substances shall be produced, subject to renewal of said term.

- The first lease was a "shallow lease" for shallow zones, which is very productive.
  - Incredibly productive: 90million barrels of oil.
  - Successfully continued by production.
- The second lease was a "mineral lease" for the deeper zones, which had not yet been developed.
  - There was an option to renew, despite lacking production. PERPETUITIES PROBLEM
  - Sent a cheque to renew both leases
    - Shallow lease letter = unnecessary due to production
    - Husky said no to renewal due to RAP
- shallow lease = set to expire, PCP did not want to renew the shallow lease because of how lucrative it was.
  - Argument defeated due to continuation by production.

Issue: How can the RAP apply to the options to renew in these two leases?

Held: The renewal clauses in both the shallow lease and mineral lease violate the RAP and are thus unenforceable.

Key Point 1: Modern affirmation of Flegal's lease is not saved by the CL exception of an option to renew contained in a lease because an OG instrument is NOT a lease

Key Point 2: Right to renew a *profit a prendre* is not a vested interest

Reasons:

- **Deep / Mineral Lease** (which had no production)**:**
  - Husky argues that they already have a vested interest, that they are just extending their existing interest and not creating a new interest.
  - BUT the existence of any conditions that must first be satisfied (ie. production) = not vested (***Flegal***)
    - The conditions here were timely notice properly given, and the payment of a prescribed fee, and therefore Husky's interest was NOT vested.
      - DP disagrees. "A remainder is vested when (1) the persons to take it are ascertained and (2) there is no condition precedent attached to the remainder other than the termination of the prior estate"
      - Also tried to argue a condition subsequent – no luck
        - "Vested interest UNTIL we fail to make a payment" (subsequent)
        - "Vested interest as soon as we make the payment" (precedent)
  - RAP applies because the first renewal period falls outside the 21 year CL renewal period. So if they renew it once it will be ok, but if it is renewed 3 times it will fall outside the perpetuities period. This lease fails because it *might not* vest outside of the 21 year period, with no limitation of a life in being.
  - The court accepts *Flegal* and refuses to apply the CL lease exemption to an OG instrument, which in substance, is a profit a prendre
  - **Husky's Policy Argument**: It must spend millions to recoup its investment on the deep lease, and thus there is no possibility of sterilization. The court rejected this, as there was no development of the mineral lease, and it was entirely possible that it could be renewed indefinitely, thereby sterilizing the minerals
- **Shallow Lease**
  - PCP also argues that since the renewal clause is invalid, that the shallow lease must fail
    - Argument fails b/c the clause is invalid, but the lease stands due to continued production.
  - continued production = the lease was in force w/o renewal. It was only perpetual renewability (resulting from the renewal clause) in the face of non-production that offended the rule.

Top Leases

- Leases executed over land that is currently leased. They **become effective when the existing lease expires**
- If an oil company suspects that the lease of a competitor may be invalid, they could approach the lessor and ask for a top lease. If the bottom lease fails or expires, then the lessor is granted their top lease
  - The top lease in effect ties up the reversionary interest that the lessor would normally retain

- Usually through a single document including all terms
- Since the top lease was an interest in land, it was registrable and allowed the top lessee to challenge the validity of the original lease on behalf of the lessor
    - In response, the original lessee would get a "top top" lease, and challenge the validity of the top lease on behalf of the lessor
        - The top top lessee would argue that the top lease violated RAP, on the basis that the bottom lease may not revert to the lessor until a time that was beyond the perpetuity period

Shell Oil v. Gunderson (1956) SCC

Facts: Shell obtained separate leases from different freehold owners (including G) in order to complete a DSU so they could produce a well. Shell, not wanting the leases to expire at the end of the primary term, inserted a Shut In Royalty (SIR) clause. The SIR clause indicated Shell's right to "pay a SIR for all wells ***on*** the said land." The well that Shell had drilled was drilled on land adjacent to G's land, not actually *on* G's land.

Issue: Was payment of a SIR for wells on the pooled land, but not on G's land specifically (the "said lands"), good enough to validly extend the lease?

Held: No, the SIR payments would have had to have been for a well on the said lands, meaning specifically on G's land.

- LEASE INVALID

Reasons:

- Strict Interpretation:
    - Going with the history of strict interpretation of OG leases, the court found that since there was no deemed production occurring on G's lands (the said lands), that the lease expired
    - As such, Shell lost this lease, along with many others
- SIR clauses amended today:
    - Note that this lease could have been saved if the SIR clause had deemed production to occur on all lands that were part of the unitization agreement
    - Therefore, today, most SIR clauses state the following → deemed production on any part of unitized land deems production to occur on all of the lands that are part of the unitization agreement

Key point: deemed production on the spacing unit is not the same thing as deemed production on the said lands.

- This can be modified by K → **might be useful to deem production on one of the sections in the DSU to be production for all**

Pan American Petroleum v. Potapchuk (1964) ABSC [IF A TOP LEASE HAS BEEN PROTECTED BY CAVEAT, YOU CAN NO LONGER AMEND A BOTTOM LEASE]

Facts: Farmer (lessor) had an original lease with Shell (lessee). Shell assigned the lease to PAP. Potapchuk secured a toplease from the farmer in the form of a 5 year option, as they thought the assigned Shell lease was going to be struck down for the same reasons in *Gunderson*.

- Potapchuk's top lease(option) was entered into in 1956, and as an interest in land was registered by caveat. PAP 'amended' their lease in 1960. Also, May 1 1961 was the date that Potapchuk accepted the option. This came *after* the expiration of the primary term of the Shell lease, but before the expiration of their *option.*
    - By registering the caveat, the interest was protected as from that date from anyone else taking an interest, or bettering or increasing any interest already held in derogation of the claim of the caveator
    - Option exercisable at the election of the optionee (Potapchuk);
    - could be terminated by optioner (Moser) under certain conditions

Issue: What happens when the Shell lease (assigned to PAP) expires? Does the top lease offend the RAP?

Held: The lease expires, and Potapchuk's option prevails, as it does not violate RAP.

Reasons:

- Shell's/PAP lease expired based on *Gunderson* – Pan Am attempted to Amend the K
    - Shell amended the lease to say "kept alive by production on unitized lands" The lessor agreed to new K
    - HOWEVER, bottom lease cannot be amended to the prejudice of a registered top lease
    - As such, when the lease expired, D held the first priority interest in the leased minerals.

- Potapchuk's option has priority, as it was an equitable interest in land protected by caveat

COUNTERCLAIM: Top Lease violates RAP b/c indefinitely renewable:

- The top lease did not have indefinite renewal. It explicitly stated that the option = 5 year period from the date of entering into the option agreement
    - IF the optioner gives 30-day notice of default to bottom lease, the top option has to accept w/in that period
    - Optioner has the right to do acts which might terminate the option
    - RAP does not apply to situations where optioner can terminate/cause termination of option
        - This leaves the door open for *Scurry v. Taylor*

IMORTANT: Recall that we talked about the leases in *Flegal* and *Potapchuk* that failed, and we raised the various issues that could have made them fail because of the RAP.

- Could save the lease with Lives in Being Clause. Renewable with a termination date, and that termination date happens within 21 years of a life in being (Her Majesty Queen Elizabeth's living decendants)

Scurry-Rainbow Oil v. Taylor (2001) SKCA [CREATED AN EXCEPTION FOR TOP LEASES SUCH THAT THEY DON'T VIOLATE RAP EVEN IF THEY MIGHT VEST OUTSIDE THE PERPETUITY PERIOD → POLICY REASON = ENCOURAGES DEVELOPMENT AND PRODUCTION]

Facts: In 1949, Taylor signed an OG lease with Imperial Oil, "for a primary term of 10 years or so long thereafter as there is production." In 1950, Freeholders OG persuaded Taylor to sign a toplease for "99 years, renewable at the option of the grantee". In 1959, Imperial Oil (the bottom lessee) had failed to drill and there was no production on Taylor's land. This lapsed the lease, and Freeholders' toplease came into effect.

- FREEHOLDER'S LEASE: "In the event that the taylor lease expires w/in 42 yrs, you agree to lease to us." The lease form attached would last 99 years with an option to renew.
- In 1956, Imperial offered a "top top lease" – why? Probably suspicious of the Freeholder's lease.

NOTE: Freeholders OG merged with Scurry in 1964, and in 1993 the company sold the lease to Tarragon. In 1993 Tarragon, enters into farm-out negotiations with Maxx. Maxx requests all of Tarragon's documents in order to conduct DD on Tarragon's title. Maxx then informs Tarragon that their toplease is void on the basis of RAP, and therefore bypasses Tarragon in the negotiations and executes a lease directly with Taylor. Tarragon/Scurry/FH sue for breach of confidence, and Maxx sues (in Taylor's shoes) for a declaration that the lease is void.

Issue: Is Tarragon's/Scurry/FH's top lease void because it violates the RAP?

Held: No, although the lease violates the 21 year RAP period, it does not violate the policy behind RAP

- The issue was not the 99 year period, but the possibility of vesting 42 years after the current lease.

Reasons:

- RAP: "no interest is good unless it must vest, if at all, not later than 21 years after some life in being at the creation of the interest"
    - "it is not sufficient that the interest may vest within the perpetuity period; rather, the interest must be ascertainable at the time of its creation"
    - Key point: RAP is tested with possibility NOT actuality

Trial: The clause of the top lease provided for possibility of 141 years of sterility. The top lease clause indicated that should the original lease become invalid within 42 years from the date of signing, then a top lease would be granted for 99 years. The top lease therefore violates the 21 year perpetuity period

- The rights on the top lease were contingent, and the period was 42 years.
    - No safety valve like Patapchuk (must be exercised w/in 5 years)

CA Majority: The policy behind RAP is "preventing the fettering of the marketability of property over long periods of time by indirect restraints on alienation"

- However, CA recognizes that top leases are an accepted business practice and actually increase drilling and competitiveness in the industry by preventing the stagnation of land
- They held that top leases are a modern instrument not thought of by the crafters of RAP
    - If your lease is about to expire & there is a top lease looming, you will drill so as to avoid losing your lease. Most of them are placed on land when the underlying lease is suspect of lapsing.
    - Therefore, a top lease is usually put on land to *prevent* sterilization
        - DP: This takes away from the principle in *Flegal* that a top lease offends the RAP b/c would sterilize land.
        - DP: This is a bad policy decision, so look at the dissent

CA Dissent: SK legislature had not acted on the SK law reform institute's request to abolish RAP. Since the legislature had not done so, the court does not have the authority to do so

DP : What if Taylor brought the action?

- Sympathies of the court might be reversed if Taylor brought this action.
- Taylor could have argued that his land has been sterilized because of the top lease
    - History of OG in SK is that after the discovery of oil in AB, Oil Co's roamed the province pressuring farmers to sign mineral leases
    - Not knowing the magnitude of the situation, farmers would agree to lease their land, with "small compensation for the nonrenewable resource"
    - DP: seems bold to overrule to CL on the basis of the *purpose* of the RAP
- Policy considerations work both ways. Oil Co's entered into top lease on reliance that the original leases might be void because of the RAP and decisions such as the ones above
    - Settled expectations works both ways
    - Ie. think of the people that entered into top leases. Throughout the 50's in Saskatchewan everyone thought that the Freeholders top lease was invalid
    - Dissent says that the courts are not equipped to weigh policy choices, and that this is best left to the legislature.
- DP would have liked to see this case go to the SCC. Tarragon (winner in the case) approaches Maxx with a settlement offer because they are fearful of an appeal, and they have 183 other similar leases in the province
    - This issue is now unlikely to go to the SCC because a party would have to lose on this point at trial and at the CA level

***SCURRY-RAINBOW* IS UNLIKELY TO BE VALID ANYWHERE BUT SASK**

SUMMARY OF PERPETUITIES

The first two cases deal with options to renew a lease. The last two do not consider an option to renew, but consider an "option and PNG lease" which is a top lease.

Flegal (option to renew a lease)

- The court followed *Berkheiser* (which dealt with a CL interpretation not a statutory interpretation) and held that the CL rule exempting an option to renew a lease from the RAP did not apply here, because this option to renew is not for a lease, its for a PNG lease
- **Renewal of a *profit a prendre* is only necessary where there is no production**
- Production would continue the lease, but here we would be sterilizing the land by allowing perpetual renewal of this non-producing lease
- The right to renew a *profit a prendre* is NOT a vested interest, <u>but if the lease is producing, then it is a vested interest</u>

PanCanadian Petroleum v. Husky (option to renew)

- Affirms *Flegal*; the right to renew in perpetuity offends the RAP
    - Production could continue the leases (which is fine), but should production cease, the option could be exercised and extend the lease in perpetuity
- It was argued that a renewal right was obtained and vested when the lease was executed
    - Like *Flegal*, this right to renew a *profit a prendre* is not a vested interest
    - Why? A remainder is vested when the persons to take it are ascertained and there is no condition precedent attached to the remainder other than the termination of the prior estate
        - Here the CP was production

PanAmerican Petroleum v. Potapchuk (option to enter into a lease, ie. toplease)

- Does a toplease violate RAP? No. The option was for the definitive term of 5 years, and it was subject to optionor's right to terminate the option
- Shell argued that had their lease been continued by production for a term of more than 21 years, and the option followed that term then it would violate the RAP

    - The court did not consider this, looking instead at the term of the option which was 5 years. This problem was considered in *Scurry Rainbow*
- The court held that if they were wrong on term of the option, there is a CL rule which says that the RAP does not apply to options where the optionor has the right to terminate

Scurry Rainbow v. Taylor (option to enter into a lease upon expiration of the underlying lease, ie. a toplease)

- If the option was exercised within 42 years (recall: 5 yrs in *Potapchuk*) of the underlying lease, the habendum of the top lease granted a 99 year term to the top-lessee and so long thereafter as there is production renewable at the option of the toplessee
- Like *Flegal*, the court looked at the purpose behind the RAP, and unlike *Flegal* held that the top lease actually encouraged development and drilling activity, and that when the RAP was formulated that this type of instrument was not contemplated by judges
- Court acknowledges that the lease does violate the letter of the RAP, but does not violate its purpose and held that this was a sufficient reason to find the lease valid
    - DP: This toplease was likely void

Brief Summary

- The CL exception to the RAP (that an option to renew a lease) does NOT apply to an OG lease, because it is a profit a prendre, not a lease (*Flegal*, *Pan Canadian v. Husky*)
- *Potapchuk* turned on a factual analysis to hold that an option to enter into a lease did not violate the RAP, but left the door open that a toplease might violate the RAP if it were exercisable outside of the 21 year perpetuities period
- The court in *Scurry Rainbow* held that a toplease that vests outside of the 21 year perpetuity period should be invalidated by the rule
    - This was even acknowledged by the court, who opted to overrule the CL using a purposive approach to the RAP.

(4) TENANTS IN COMMON

Prairie Oil & Gas Co v. Allen (US Case) [TIC IS ENTITLED TO PROCEEDS IN PROPORTION TO THEIR INTEREST, LESS REASONABLE AND NECESSARY EXPENSE OF PRODUCING AND MARKETING]

Facts: A purchased the surface rights to a parcel of land, and also received 1/10 of the Oil and NG. The remaining 9/10's had been sold prior to her purchase of the land to P. P leased the land and produced oil from the land, but claimed that they did not have to pay A for the value of the oil because A should only recieve the net proceeds from the oil after deducting reasonable expenses. In other words, she was entitled only to a 1/10 share of the profit from the oil, not a 1/10 share in total sale proceeds.
Issue #1: Did P have to receive A's consent before starting drilling?
Decision: A co-tenant does not have the ability to interfere with the rights of the other co-tenant to work and produce minerals. While the consent of the co-tenant is not required, both co-tenants have the same rights to drill for or produce O&G.

- A could have also leased her 1/10 interest in the land to another producer, and both oil companies would have the ability to enter on and drill the property, BUT neither party would have had exclusive possession.
- There was no trespass on A's interests because consent had been granted by the other 9/10 tenant in common
- A was entitled to her portion of the net proceeds of the oil (market value less reasonable costs of production)

Land Titles Act s.65

- The registrar shall not register a transfer that has the effect of severing a joint tenancy unless
    - a) the transfer is executed by all JT's
    - b) All Jt's other than those executing the transfer have given their written consent; or
    - c) The registrar is provided with satisfactory evidence that all JT's who have not executed the transfer or given their written consent have been served with written notice of the intention to transfer.

Chapter 4: The Freehold Oil and Gas Lease

INTRODUCTION

- Reached back to USA: found the general form based on "producers 88 form" – developed in 1916 by mid-continent oil & gas company.
- Many leases have survived for a long time because of continuing production → a lot of leases extend the primary term if there is continued production
- Production, if not defined in the lease, does not have a common law meaning. As such, many old leases are still in force today and we need to know the anatomy of these leases and how to avoid the problems that plague some of the old clauses
- In an oil and gas lease, the oil company (lessee) wants to build up a portfolio of prospects so they can develop it at a later date when it is profitable to do so. The lessor wants to get money now
    - This is the common tension in O&G development
- **Key difference between oil and gas:** An oil well can be produced a bit and put into storage in order to prove production. This cannot be done with a gas well, as they are connected to pipelines.

(1) OVERVIEW OF CLAUSES IN A FREEHOLD LEASE

1 **Two Primary Models: CAPL99 and Bishop**

2 **Granting Clause:** Provides the lessee with the right to seek and extract substances (ie. a profit a prendre)

- Contains a legal description of which substances are being conveyed (petroleum, natural gas, coal bed methane), and where they are located (based on surveying from chapter 1)
- Ex. "DOTH HEREBY GRANT AND LEASE Unto the lessees all the petroleum, natural gas and related hydrocarbons (except coal and valuable stone)."

3 **Habendum Clause:** Describes the duration of the interest → **the heart of the lease**

- Ex. "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."
    - **Specifies the duration**
    - The primary term here is 10 years
        - NOTE: year = Day b4 date (ie. July 31, 2014-July 30, 2015)
        - Birthday of final year = death day.
    - The extended term is how long the lease can continue after the primary term expires, ie. "as long as the leased substances are produced"
        - This is troublesome, as "production" is usually not defined. If its not defined in the lease, we have to look to the common law, but there is no Canadian CL definition of "produced"
            - Instead, we can look to the "reasonable operator" test from *Clifford* (US)
            - **CAPL lease has a definition**
        - EVENTUALLY, changed the term to "operations" or "operation or production"
            - Operations = puttering around on land
            - Production = actual production of oil & gas.

CASES FOR HABENDUM

- **Kinnimonth:** Habendum as Condition Precedent to extend beyond 10 yr term
- **Murdoch:** can repair a defect in a lease by normal contract
- **Cull v Canadian Oil:** terms said right to drill to completion w/ reasonable diligence. Court said they could *bring it into production w/ reasonable dispatch & diligence*.
    - A lease with a capped well can only be kept alive by paying the SIR before the end of the primary term, whereas a lease with a producing well can be kept alive by bringing that well into production with reasonable diligence and dispatch.

Timing of the end of a lease

- December 29 was the critical date in *Cull* because the lease was entered into on December 30. It is a real trap, and there is a lot of litigation over when payments have to be made and when production has to be achieved for the purposes of the OG lease
    - **CULL:** Production was not achieved by the anniversary date, but construction of the well was complete, the lease will be extended if you bring it into production using reasonable diligence and dispatch
- In *Ballem v. Texas Gulf*, the payment was due on Oct 11 (Thanksgiving Monday), and the lessee made payment by registered mail on Oct 8. It was delivered to the bank on Sat Oct 9. The lease said that you could pay the named depository. The court said the payment was made in time because it was at the bank depository prior to Oct 11
- In *Pancon*, the date of mailing constituted payment (see above)

DEFINING PRODUCTION – Capable of Production (OMERS) is the more common term.

- **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*)

2 (A) Proviso 1: Delay Rental Clause: Requires the lessee to pay the lessor if they fail to drill a well within a specified time (usually 1 year); (usually a dollar an acre)

- Ex. 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
- In a 10 year term, there would be 9 delay rental payments due (one each year)
- OG leases are strictly construed, so if you are a day late, the lease is dead
- Two types of Delay Rental Clauses:
    - **"Unless" Clause:** "The lessee may defer operations for one year if it pays a delay rental. The lease will terminate unless the payment is made. If they do not pay, the lease will automatically terminate."
        - Drilling a well within one-year is a **condition precedent of the lease**, and thus if the well wasn't drilled within the year or a delay rental payment made by the anniversary date, then the lease will terminate
        - DEFAULT CLAUSE INAPPLICABLE
- Condition where if failed, there is no K.
    - **"Drill or Pay" Clause** (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 remedy the problem."
        - This requires the lessor to notify the lessee of the breach, and the lessee then has a specific period of time to correct the situation. And if they fail to do so then the lease terminates.
        - Doesn't create a condition, it creates a contractual term.
        - DEFAULT CLAUSE APPLICABLE

2 (B) Proviso 2: Dry Well Clause: When a lessee drills a dry well during the primary term, the lease terminates UNLESS they pay the delay rental → **have to pay delay rental in lieu of production royalties**

- "If at any time during the primary term and prior to the discovery of production on the said lands, **the lessee shall drill a dry well** or wells thereon, or it at any time during such term and after the discovery of production on the said lands such production shall cease and the well or wells from which such production was taken shall be abandoned, **then this lease shall terminate** at the next ensuing anniversary date hereof **UNLESS the lessee shall have paid or tendered the delay rental**, in which latter event the immediately preceding proviso hereof governing the payment of the delay rental and the effect thereof shall be applicable thereto"

2 (C) Proviso 3: Continuous Operations Clause: Allows a lease to continue after the expiry of the primary term if the drilling or production is interrupted by something beyond the lessee's control

- *Kininmonth* held that you **have to balance the Habendum and Proviso 3**
    - Can only apply after production is achieved and the primary term has expired → **a delay rental has to be paid for the termination of the primary term**
- Ex. "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."
- Usually you get 90 days to resume operations.
- Typically requires the reason to be enumerated and beyond lessee's control: collapse/intermittent market; natural disaster etc

CASES: CONTINUOUS OPERATION

- **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 if as long as they were taken in (1) good faith, (2) with reasonable diligence, and (3) more than simply minimal.
- **Kinnimonth (1964):** Proviso 3 is subject to the habendum – requires production BEFORE it can be extended by production.
    - Habendum as Condition Precedent to extend beyond 10 yr term

4 **Shut in Well Clause:** Allows the lessor to shut in the well, ceasing actual production, and making a payment (a shut in royalty) to the lessor that will deem the well to be in production. → SIR = constructive production

- **Deemed production** occurs if you drill a well, do not immediately produce it, but shut it in for one of the reasons permitted in the lease
    - Drilling and producing keeps a lease valid, and no further payments are required except for royalties
    - Drilling and not producing (ie. shutting in a well):
        - Generally only **2 reasons**: lack of or an intermittent market, OR causes beyond lessee's control
        - Must Read *the exact words of the lease*
        - Onus = on producer
- Ex. "If all wells on the said lands are shut in, suspended or otherwise not producing during any year ending on an anniversary date as the result of a lack or an intermittent market, or any cause whatsoever beyond the lessee's reasonable control, the lessee shall pay to the lessor at the expiration of each said term a sum equal to the delay rental hereinbefore set forth, and each well shall be deemed to be a producing well hereunder."
    - This payment is known as a **"shut in royalty"**
- Must look at the shut in well clause closely to determine what is deemed production and how it is achieved, what is timely payment ,and what the prerequisites are to shutting a well.
    - Deemed production must be achieved by the lessee before the shut in royalty is paid to the lessor
    - The shut in royalty must be paid prior to the anniversary date of the lease (some liberalization on this in *Cull* and *Durish*)
        - W/O Royalty payments, the lease expires.

- **STRICTLY CONSTRUED → TO DO OTHERWISE WOULD UNDULY DISADVANTAGE THE LESSOR**

CASES:

- **Cull (Murdoch):** lease can be extended by SIR payment, but only when payments are received.
- **Hambly/Paddon-Hughes:** Clause allowed the lease to be extended by commencing to drill if it results in production of paying quanitites; Spud-In a well, finished well and tried to pay SIR after. NO GO. Essentially: tried to pay shut-in after expiry of extended term.
- **Kissinger Petrolium:** Can make a SIR payment before shutting in the well
    - **INCLUDING** during an 'extended by operation' period

- **DURISH: 1)** Shut-In Well clause terms are the concern; 2) Can't backdate SIR payments; 3) SIRs are not obligations, they are options. Default clause does not apply. Failure = dead lease.
- **TEG HOLDINGS:** No access to carrier ≠ "out of control" b/c can apply to ERCB; Lack of Intermittent Market must be proven by producer: 20 year period, definitely a market at some point.
- **FREYBURG:** Shut-In b/c of personal interest, claimed market even though their were producing other wells on the same field.
- **Kensington Energy v B&G:** The 90 period of proviso 3 is not read into the shut-in royalty. Deemed production is deemed production for the during and does not require continuous operations so long as it is shut in for a legitimate reason.

5 **Offset Well Clause: ["Drill or get off my land"]** When a lessor discovers that the neighbor has a successful well and they are worried about that well draining the OG from their land, they can oblige the lessee to drill a well or get off the land. (due to fugacious nature of oil and gas, as well as the Pennsylvania theory of ownership

- Ex. In the event of commercial production being obtained from any well drilled on any **SU laterally adjoining the said lands and NOT owned by the lessor** (or if owned by the lessor, not under lease to the lessee), then unless a well has been or is being drilled on the SU of said lands laterally adjoining the SU on which production is being so obtained…**the lessee shall, within six months** from the date or said well being placed on regular production either:
  - (a) Commence or cause to be commenced operations for the drilling of an offset well; OR
  - (b) Surrender all or any portion of said lands
- NOTE: "Laterally and adjoining SU" does NOT include SU's whose diagonals are touching. It only includes SU's whose sides are touching
- Commercial production (unlike production) is defined: Output from a well of such quantity of the leased substances or any of them as, considering the cost of drilling and production operations and price and quality of the leased substances…would commercially and economically warrant the drilling of a like well in the vicinity thereof
- In modern offset well clauses, lessees have the power to pool or unitize lands with other lands (and producers) and allocate the lessor's share of production (ie. they don't actually have to drill a well on the land).
  - **They are able to sign agreements that allow their lessor to enjoy in the profits from drilling in a common "unit" or "pool" without actually having to undertake drilling operations**
  - Alternatively, lessees can pay a compensatory royalty (equal to what would be payable if the adjacent commercial production was occurring on the lessor's land)

6 **Pooling Clause**

- Pooling: The voluntary or compulsory combining of tracts to form a DSU.
- Unitization: The voluntary combining of DSU's to form a unit or field
- Typical pooling clause would read: 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 Mr. B's land with the 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 lands with which the said lands may have been pooled" *(Patapchuk)*

7 **Default Clause:** Relates to a breach, non-observance or non-performance of any covenant in the lease by the lessee. It **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.

- Failure to pay a delay rental is NOT a breach, as it is simply an option. Neither is a shut-in royalty. In both scenarios, the lessee never agreed to make the payment (both are condition precedents)
- Breaches apply only to obligations, not options
- Typically construed as conditions precedent
  - Departs from first principles, but is a contractual modification

8 **Manner of Payment Clause:** Requires the lessor to designate the depository (ie. RBC main branch Calgary) that the lessee can make payments to. This is important because if the lessee fails to make payments of a delay rental or SIR in a timely fashion, the lease is dead.
- A mailing clause can also be included, which poses obvious problems
- General Rule: payment made by mail is deemed to be received at date of posting (*Paddon Hughes*)
- **CRUCIAL PART OF THE LEASE**

9 **Lessor's Compensation Package:**
- Under this lease, the lessor is entitled to:
  - **(1)** $_____ signing bonus; AND
  - **(2)** Royalties that occur upon production. Initial clause offers the lease substance "in kind" (actual barrels of gas). OR, In this lease, the lessor receives an amount equal to the current market value of 12.5% of the gas produced and marketed from the said lands during the preceding month (ie. the wellhead price) → **typically negotiable**
    - Why is current market value used instead of the selling price (the price that the lessee sells to the refinery)? Oftentimes the lessee will own the refinery that they are selling the oil to, and therefore the selling price would be too low.
    - Another problem: Imagine that the leased lands produce one type of gas (ex. sour gas) and that gas is taken away by pipeline to a refinery, and the gas is converted into sellable gas. Sour gas and sellable gas have different prices
      - The lessor is getting their royalty based on the market value of the sellable gas, and therefore the cost of extracting the sour gas and producing it is borne solely by the lessee. Solution: **Jumping Pound Formula**
        i. This is problematic now because the ERCB does not regulate this anymore, and therefore the operator can unilaterally determine what rate of return they want on their investments. The lessor gets a cheque but does not see these deductions
        ii. **Note:** The costs differ from oil to NG. Oil is sold pre-refinement, it only required minimal seperation costs and these were traditionally borne by the oil company.
        iii. However, 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)
          - The price here are the costs incurred after product but before sale (usually de-watering & stuff)

NOTE: Valuation of Gas
- "12.5% of market value on the **said lands**" that is a hypothetical number. BECAUSE:
  - First stage: no market value; then sent via pipeline to processing plant, and then sold from the "tail gate"
- Takes: price achieved at tailgate of processing plant, then deducts: proportionate cost of transport & processing
  - If tailgate price is $3.50, the market value on the land may be $2.75.
- **"Jumping Pound Formula"** = TG Price – transport & process – allowance for capital costs of building the pipeline and plant (based on assumption that it was 50% debt & 50% capital)
  - Determination of this formula is done by Oil Companies.
- Gas Cost Allow Document: very rigorous as to determining what costs may be deducted, reinforced by the department of energy.
- Similar principals apply to oil.
- NOT the selling price, which can vary substantially.
  - May even technically require market value PER DAY
  - Often this clause is dealt with by accounting, not legal department.
- Also prevents internal distribution (ie. company selling the gas to their refinery at a discount since it gets marked up at the end).
- Said lands: doesn't have an MV b/c no value until its sold at the tail gate processing plant
  - Jumping Pound accounts for transporting & processing to know what the retroactive value when extracted
  - Cost of bringing it to the surface is solely covered by the company (land owner gets the oil to surface free of charge)

(2) THE HABENDUM, CONTINUOUS OPERATIONS, AND DELAY RENTAL CLAUSE CLAUSES

Paddon Hughes Development Co v Pancontinental Oil Ltd. (1998 ABCA) (**if payment by mail is allowed in the contract, payment is effected on the date of mailing → READ A TERM INTO THE CONTRACT SO THAT IT MADE MORE SENSE)**
Facts: Pancontinental (P) was the current lessee of two pooled leases owned by Thatcher and Bishop. Paddon Hughes (PH) was the top lease holder, and would have received the leases if they lapsed with P. The main problem is the date that a delay rental payment is considered received. The one year anniversary of the leases required payment by August 17 and 20th respectively. P claims that the cheques were mailed in the prescribed form on August 9, but the TD bank did not issue a notice of receipt until August 26 and September 4, respectively for the payments.
Issues: Were the delayed rental payments made within the one year time period to continue the lease?
Decision: The Bishop lease specified that mail was an appropriate method of payment, implying that payments are considered received when they are mailed (i.e. Aug 9th) which occurred prior to the 1 year period (the lease is valid). The Thatcher lease did not specify when payment was received or the method (the mailing clause (21) in the Bishop lease had been modified in the Thatcher lease).

- While the lease did not specify whether payment could be received by mail, it did provide a clause that payment "should be received at X address"
- **Leases are typically interpreted strictly**
- This was interpreted by the court as indicating that mail was an appropriate method of payment and the payment was affected by the date of mailing
    - Court essentially read-in a modification of the postage rule because the amendments were ambiguous
    - **ON APPEAL, THE FACT THAT AN ADDRESS WAS PROVIDED AND THE RECIPIENT WAS IN A DIFFERENT COUNTRY IMPLIED MAIL WAS SUFFICIENT**
- PAYMENT WAS MADE WHEN THE CHEQUE WAS MAILED
- **Dissent:** Mailing a payment was differentiated from the typical postal rule of offer and acceptance. Bishop specifically specified mailing as an appropriate payment so it was correct to deem the payment made at the time of mailing, the Thatcher lease was silent and other jurisprudence indicates that a payment is not made until it is received.

Canadian Superior v. Crozet Exploration Ltd (1982). [**SHIFT TOWARD THE PURPOSIVE ANALYSIS; TEST FOR WHETHER THE OPTION TO EXTEND WAS EXERCISED: 1) PREP STEPS TAKEN IN GOOD FAITH; 2) TAKEN WITH REASONABLE DD AND DISPATCH; 3) PREPARATION MUST PAST DE MINIMUS THRESHOLD**)
Facts: PNG lease entered into on July 31, 1975. Primary term was to expire at midnight on July 30, 1980. Crozet had a toplease. On June 4, 1980, CSO granted an option to drill on the leased lands to Surf (not a farmout because Surf wanted to learn the results of drilling operations on adjacent lands in which it had an interest). Surf exercised that option on July 22, 1980. Surface lease obtained on July 23, 1980. July 24th survey of the access road and well site was completed and the responsible contractor started constructing the access road. The combination of substantial rains and a sloped site required Surf to bring in gravel to stabilize and level the site. This was completed on July 28, 1980. Sump pits, rat hole, and mouse hole were drilled on July 27. On July 30 the dismantled rig moved on site ready to be hoisted vertically. July 30 "rigging up" commenced. Well licence issued on July 30. Derrick raised to vertical position on July 31. Well spudded in on July 31. Well started producing and continues to produce at the time of litigation.

- Habendum clause allowed the primary term to be continued as long as operations, as hereinafter defined, are conducted on the said lands
    - **Key point: Primary term + operations (NOT production)**
- **Operations shall mean:** drilling, testing, completing, reworking, recompleting, deepening, plugging back or repairing of a well in search of or in an endeavour to obtain or increase production of the leased substances or any of them, excavating a mine, production of the leased substances or any of them (whether or not in paying quantities), or operations for or *incidental* to any of the foregoing.
- NTD: Why are all these facts here? Could be in a fact pattern on the exam.

Issue: Was the lessee conducting "operations" at the end of the primary term (midnight on July 30)?

- What was sufficient to deem operations such that the lease would extend??

Held: The lessee was conducting operations at midnight on July 30, and therefore their lease is valid and subsisting.

- Incidental include preparatory steps, as long as they were taken in good faith, with reasonable diligence, and more than simply minimal.

Lessee: The general rule seems to be that actual drilling is unnecessary, but that the location of wells, hauling lumber on the premises, erection of derricks, providing a water supply, moving machinery on the premises and similar acts preliminary to the beginning of the actual work of drilling, when performed with a *bona fide* intention to proceed thereafter with diligence toward completion of the well, constitute a commencement of well or drilling operations within the meaning of this clause of the lease
Lessor: Operations for or incidental to drilling do not include work preparatory to drilling, and that spudding must be had prior to the expiry of the primary term
Court: Drilling is not required. Preliminary acts were conducted with a bona fide intention to proceed with diligence to completion
NOTE: A harsh interpretation of the lease would have deemed the lease to be dead. This case represents another flexible approach like *Cull*. These two cases are the beginnings of a more purposive approach to the lease. Court refers to *Cull* and accepts the proposition that there is a "liberalization" of the absolute strictness of interpreting leases.
NOTE: Court said that a test for this lease (although maybe not others) would be: (1) preparatory steps must be taken in good faith with the intention of completing the well, (2) preparatory steps must be taken with reasonable diligence and dispatch tested by the principles of good oil field practice, (3) preparatory steps must not simply be minimal

Canada Cities Service Petroleum v. Kininmonth (1964) SCC (**THE PROBLEM EXPLORED IS WHERE A WELL IS DRILLED IN PRIMARY TERM, BUT NO PRODUCTION UNTIL AFTER; HABENDUM CLAUSE IF THE CRITICAL CLAUSE—NOT PROVISO 3; OPS CAN EXTEND THE LEASE, BUT ONLY IF LEASE HAD ALREADY BEEN EXTENDED BY PRODUCTION OR DELAY RENTAL PAYMENT**)
Facts: OilCo (lessee) obtains a 10 year lease from Kininmonth (lessor) on May 11, 1951 to drill an oil well. The lessee must get production before the end of the 10 year term (May 10, 1961). Oil Co availed itself of the right to postpone from year to year its drilling commitment by paying the delay rentals. OilCo drilled a well in March, 1961 and found oil in the Cardium sand formation. At the time, the ERCB had specified a special spacing unit for the Cardium area of ½ section being either the east or west section. OilCo's lease only covered the south section. ERCB says that lessee has to cap their well and cannot produce until the proper half section is acquired. OilCo wanted to bring the producing well equipment on site, but there was a road ban in effect, and the well did not produce until June 26, 1961. ERCB immediately ordered OilCo to cease production because it had not acquired the prescribed SU. Well drilled w/in term, but came into production after the primary term.
Issue: Although production had not occurred by the 10 year anniversary, could this lease be saved by the fact that the OilCo had commenced operations before the 10 year term which eventually led to successful production?
ABCA: The road ban was not "sufficiently outside" the control of the lessor to evoke the continuous operations clause. → **They knew it was likely to happen**

- Dissent (Macdonald): The lease allows an appellant, so long as they do so in good faith, to take to completion a well that has been commenced inside the primary term, and production from this well would continue this lease.
    - Felt that the suspension of drilling by the board (as the lessee did not have prope SU's) was outside the lessee's control and was required to be obeyed, allowing the continuous operations clause to continue the lease.

RATIO: PROVISO 3 only applies after the primary term has already been extended by production.
Held: No. The paramount term in the lease is the habendum. "So long thereafter as there is production" requires production during the primary term. The lease dies on May 10. Proviso 3 (continuous operations clause) does not resurrect the lease.
Reasons:

- **Habendum clause:** "To have and enjoy the same for a term of 10 years from the date hereof, and so long thereafter as the said substances or any of them are being produced from the said lands, subject to the sooner termination of the said term as hereinafter provided."
- **Proviso 3 – Continuous Operations Clause:** "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."
    - **Court:** This clause is designed to deal with the situation where the primary term has been extended by production and such production ceases outside the primary term. Without this clause, the lease would automatically terminate upon cessation of production. This clause allows the leases to be continued provided that the lessee is continuing operations on the said lands.

- **Martland's Interpretation of the Habendum:** He treats it as a condition precedent to the extension of the lease beyond the 10 year term: "I cannot construe the paragraph as meaning that, even though no production has been obtained within the 10-year primary term, the lessee may thereafter carry on drilling operations on the land which, if successful, will then serve to extend the lease for a further period during the continuance of such production. The latter part of [the continuous operations clause] covers the situation which may occur if drilling, working or production operations are interrupted or suspended by causes beyond the lessee's control. In my opinion this clause only comes into effect if the lease has already been extended beyond the 10-year primary term, as a result of production, and then such production ceases."
    - **Nothing can extend the lease beyond 10-**years except production; PROVISO 3 applies for situations arising outside of the 10-year term, not to help build a bridge to cross that threshold.
- **Lessee's Argument:** Although the primary term has expired, they are engaged in drilling and working operations which is sufficient to keep the lease alive. The court disagreed
- **Fallout:** Caught the industry by surprise, lessees believed they had a right to continue the lease.
    - In contrast, in America, "the right to commence a well during the primary term, carries with it by necessary implication the right to continue the well after the expiration of the primary term" is given a purposive interpretation, meaning that you have the right to start drilling during the primary term, and finish drilling at the end of the term (this is the purposive interpretation)
    - Martland in Kininmonth uses strict construction, meaning that there must be actual production, not just drilling, by the end of the primary term.
        - This means that if at the end of the said term the leased substances are not being produced, then the lease is dead.
        - The proviso is subservient to the Habendum. Habendum must be satisfied b4 provisio can apply.
    - Note: Plaintiffs were very successful – Oil Co has to leave the land, and P gets a producing oil well.. This allows the lessor contract a very favourable royalty agreement with another OilCo as all the next OilCo has to do is open the tap (and I think get an order for the proper SU from the ERCB)
    - Note2: Possibly a huge unjust enrichment issue here, but we will look at this a bit later.
    - Note3: OG industry changed the term 'production' in the habendum to 'operations' in new leases, but there are many leases that still have the Kininmonth problem

***Sohio Peroleum Co v Weyburn Security Co* [ARGUING ESTOPPEL TO KEEP LEASE VALID NEEDS MORE THAN MISTAKEN BELIEF AND PASSIVE CONDUCT → WOULD REQUIRE ACTIVE MISREPRESENTATION]**

- Applied SCC in *Kininmonth*, but found that the delayed actions of the producer weren't the result of misreps or prejudicial conduct, so no estoppel available
- Mineral takes and royalties were paid and accepted, and a pooling agreement was entered into—requiring the lessor's consent. → but both parties had honest but mistaken belief

Cull v. Canadian Superior (1972, SCC) [UNIQUE LANGUAGE IN CONTINUOUS OPS CLAUSE EXTENDED LEASE BECAUSE DRILLING WAS SUFFICIENT]

Facts: Lease expired on December 29. CS completed the well on December 28, and it was producing. 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 where there was no drilling and no production. According to Martland's approach from *Hambly*, the lease should have been dead.

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 reasonable diligence and dispatch, and if oil or gas be found in paying quantities, this lease shall continue and be in force with like effect as if such well had been completed within the term of years herein first mentioned."

- **Gave the lessee the opportunity to keep drilling so long as they had begun drilling in the primary term, even if no immediate production**

Habendum Clause: This lease shall be for a term of 10 years and so long thereafter as oil, gas or other mineral is produced from the said land hereunder, or as long thereafter as the lessee shall conduct drilling, mining, or reworking operations thereon as hereinafter provided and during the production of oil, gas or other mineral resulting therefrom.

Lessor's Argument: The above clause only extended the lease until completion of the well. It could only be continued thereafter if production was being obtained from the leased lands, and there was no production until 6 days after the well was completed. Therefore, we have the same "fatal gap" as the lease in *Hambly*.
Issue: Whether the lease expired because of no production
Held: The lease is valid and subsisting.
Reasons:

- The lease in *Hambly* contained a provision similar to this one. The lessee commenced to drill a well shortly before the expiration of the primary term, which was completed thereafter. It was a gas well and there was, at that time, no available market for gas produced from it. It was not intended to be put into production nor was it put into production. The lessee did not seek to avail itself of its privilege to pay money, in lieu of production, until a week after completion of the well.
- 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 COC indicated that the lessee had the right to drill to completion with reasonable diligence and dispatch, but did not say anything about bringing the well into "production" with reasonable diligence and dispatch.
- 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**
- They had the right to drill a well until midnight of the day the lease expires. You could not reasonably bring it into production that day.
    - Therefore, the lease is extended if you acted with reasonable diligence and dispatch to bring the well into production
- **Key Point:** This case turns on actual (*Cull*) vs. deemed production (*Hambly*)
- **CASE TURNED ON UNIQUE LANGUAGE IN THE CONTINUOUS OPS CLAUSE**
    - Basically addresses an inevitable gap between the end of operations and the beginning of production
- A lease with a capped well can only be kept alive by paying the SIR before the end of the primary term, whereas a lease with a producing well can be kept alive by bringing that well into production with reasonable diligence and dispatch.
- Deemed production (Shut-in well for reasons beyond lessees control, where you pay a shut in royalty to begin production) must be obtained prior to the termination of the primary term (*Hambly*)
    - You do not need the extra time for the service rig because you are not bringing the well into production.

NOTE: *Cull* and *Hambly*, unlike the other failed lease cases, had additional language to the effect that the lessee, if engaged in drilling operations during the primary term, will have the right to complete that well with reasonable diligence and dispatch.

Most of these cases turn on when production commenced. We have to determine when drilling began, whether there was a gap between expiry of primary term and production, and what the lease has to say

Canadian Superior Oil v. Murdoch (1969) SCC [SIR DEEMS PRODUCTION, BUT MUST HAVE BEEN PAID BEFORE EXPIRY OF PRIMARY TERM IN ORDER TO EXTEND THE LEASE]

- The Murdoch Problem.

Facts: Ms. M granted a 10 year lease to OilCo on April 22, 1950. Lease expired at midnight April 21, 1960. The lessee farmed out the job of drilling the well to Amax, who drilled on March 12, 1960 and finished on April 20, 1960. The well was brought into production after the lease expired. Lessee promptly says to ERCB that they would like to shut in the well. This is granted on May 6, 1960, and the lessee sends a SIR cheque to the lessor on May 16, 1960. The lease was dead because there was no actual production, and no deemed production (because deemed production can only occur on the date of the payment of the SIR, which in this case was after the expiration date of the lease). A year later another Oil Co looks at the lease and determines that CSO did not have the required authorizations to get the lease as Mr. M had an interest in the land. CSO files a caveat. Mr. M seeks an action to remove the caveat. Action settles and CSO enters into a settlement agreement that indicated the old lease was still alive and valid. As a result, CDN Superior has protected its interest under the settlement agreement. Ms. M gets sick of dealing with CDN Superior, and makes a claim in 1961 that the entire original lease was invalid because at the end of the primary term there was no production.
Issue: Deemed production did not result until May 16, 1960, which is after the expiration of the primary term, however, is this lease nonetheless valid as a result of the contract?
Held: Yes
Reasons:

- The original lease expired on April 21, 1960 as there was no actual or deemed production as required by the habendum clause
- However, the lease was extended by the contract (a subsequent agreement) entered into between the parties
- Lower courts decided this case on the basis of estoppel, SCC says that this is not an estoppel case, Mrs. M simply cant get out of the lease because she contracted away her ability to do so.

Key Points:

- 1) A lease can be extended by deemed production, but this requires a shut-in royalty (SIR) to be paid. Here the well was completed within the primary term, but the cheque was paid afterwards. This means that there was no production and no deemed production for a certain window.
- 2) Parties can repair a defect in a lease (not through estoppel) but through a normal contract
- Gave rise to a series of cases: lease is terminated, but the lessee argues that the lessor is estopped.

Canadian Superior Oil v. Hambly/Paddon-Hughes (1969) ABSC (cf. Cull) [NEED ACTUAL OR CONSTRUCTIVE PRODUCTION TO EXTEND PRIMARY TERM; THERE MUST BE AN EXISTING RELATIONSHIP → IF LEASE TERMINATES, ESTOPPEL ISN'T AVAILABLE]
Facts: A lease with a primary term of 10 years was entered into June 17, 1948. Farm out agreement was executed on June 5, 1958. Farmee commences drilling on June 10, 1958. Well is finished on August 8, 1958. Apply to ECRB to shut the well in, and then send a royalty cheque on August 13.

- OilCo had been alive to the Kininmonth problem, and had attempted to amend the problem with the old continuous operations clauses by inserting clause 12, which says that: "If the lessee shall commence to drill a well within the term of this lease or any extension thereof, lessee shall have the right to drill such well to completion with reasonable diligence and dispatch, and if oil or gas be found in paying quantities, this lease shall continue and be in force with like effect as if such well had been completed within the term of years herein first mentioned."
- Effectively, the lessee shall commence drilling sometime during the term, but shall have the right to complete the well outside the primary term using reasonable dispatch.
- August 9, 1958 drilling production ceases, the lessee suspends the well and makes an application to shut it in, makes a SIR payment that is received on August 14, 1958. Why is the lease invalid?
    - Note the fatal 5 day gap where there is not drilling operations or production/deemed production (i.e. between the time the well was completed 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.

Issue: Is the lease alive at all at the time the well was finished? Is there any chance for an estoppel argument?
Held: No; No.
Reasons:

- **The lease fails**
    - Clause 12 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"
    - However, the SIR was not made during the extended term, but only *after* drilling was completed
        - Recall: *Murdoch* says that "SIR's must be paid before the expiry of the primary term if it is to be effective to continue the lease beyond its primary term"
        - The lease was extended by operations, but the SIR cheque was not sent until 26 days later (no production/deemed production and no operations)

Republic Resources & Joffree Oil v Ballem **[THERE WAS A GAP B/W PRIMARY TERM AND PRODUCTION → LEASE TERMINATED; NO ESTOPPEL BY SILENCE, EVEN IN THE CASE OF A SOPHISTICATED REPRESENTOR]**

In sum:

- If there is a clause permitting drilling activity after lease terminates, that activity must have begun before termination date
- Acceptance of payment, nor silence, is sufficient for estoppel → particularly with unsophisticated parties
- *Kinnimonth*: if SIR is deemed production, must have been paid before termination (fatal gap)

(2) Production:

- **Production of leased substances can be relevant throughout lease's lifecycle**
- **Another important consideration is how a well is being operated: is it for production or just speculation?**

Common law meaning of "Production"

- Typically the habendum will state "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"
- While "commercial production" is sometimes defined, "production usually is not"
    - If production is defined, we can just look to the lease
    - If it is NOT defined, we must look to the common law, but there is no Canadian authority on the subject here
        - One authority is an American case called *Clifford v. Koontz* (reasonable operator test)
        - Well that had been dribbling production for 16 months. Some production from the well, but it did not cover operating costs. Well was reworked, and the result was a massive increase in production (1800%). Lessor sees his chance and says that the lease expired in those 16 months because there was not enough production.
            - How small does production have to be before the lease is invalidated?

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*)

- **"how long will a lease last when it says "as long as there is production?"**

Bearspaw Petroleum Ltd. v Encana Resources Ltd (2011 ABCA) [PRODUCIBLE = SOMETHING LESS THAN <u>IMMEDIATE</u> PRODUCTION, BUT MUST IN FUTURE BE CAPABLE OF MEANINGFUL QUANTITY → PRODUCIBLE DOESN'T NEED TO BE IMMEDIATE PRODUCTION, ENTITLES OPERATOR TO SIT ON A WELL IF THERE'S A LEGITIMATE REASON TO DO SO]
Facts: B had drilled several NG wells that tested well for volume of NG, but were not connected to an existing pipeline. E challenged the validity of these leases on the basis that the leases were expired because this did not meet the requirement of being producible (i.e. producible meant the ability to be able to bring the gas to market)
Issue: What is meant by the term producible?
Held: The requirement that a pipeline exist for every completed NG operator to maintain their lease would not be commercially viable. Producable does not mean that the well must be capable of immediate production, but rather additional steps may be required to bring the NG to market. There is no implied or express convenant that a pipeline must be tied in to bring gas to market prior to completing the wells.
Ratio: Producable means the ability to produce quantifiable amounts of natural gas, but does not require that everything be completed to bring the gas to market (i.e. a pipeline)

- Producable = turn on the valve and it'll produce.

Omers Energy v Alberta (ABCA 2011) [PAYING QUANTITIES TEST ISN'T RELEVANT; TEST FOR CAPABLE OF PRODUCING: 1) WELL MUST BE CAPABLE OF PRODUCING IN CURRENT STATE (FLIP THE SWITCH); 2) PRODUCTION MUST BE <u>MEANINGFUL</u> QUANTITY → MEANINGFUL = LEVELS ASSOCIATED WITH PROFITABILITY OR COMMERCIAL VIABILITY]
Facts: A lease was granted (a standard form CAPL alberta lease) and Omers received a well license to drill under this lease. Omers informed the lessor that the lease was continued by production from a well beyond the primary term of the lease ending, and because of allowable pooling arrangements that also continued to produce. When the well encountered problems, it was shut-in, and did not produce until a period 3 years later. By this time the lessor had entered into a new lease with a different lessee, but Omers drilled two new wells and attempted to produce until their liceneses were revoked pending the completion of this dispute.

- Lease expired FEB 2006, but extended thru production.

- Well shut-in march 2006 until may 9 due to water issues. 13 MINUTES of product in may, then 3 MIN in November, then 119 HOURS in January.
- Could this well be said to be in production?

Issue: What level of production is required for the initial lease to remain valid and subsisting?
Held: The ECRB concluded that the suspended well clause and the habendum clause read together meant that for the lease to continue the well must be a) shut-in BUT capable of production b) within the 90 day cessation of operations period (i.e. a non-producing well had 90 days to be revived).

- "Capable of producing" required:
    - a) the capability to produce NG (the well must have the **ability to produce in its existing configuration and state of completion**); AND
    - b) the capability to produce <u>meaningful quantities of the resource</u> (some volumetric quantity of NG)
        - This is similar to paying quantity in the US. It is not an issue if the production is clearly profitable (i.e. it does not require precise quantification)
            - Would an objectionably reasonable operator, acting prudently and for the purpose of making profit (not mere speculation) continue to operate the well in the same manner?
- The water logging problem being faced by *Omers* meant that the well was not capable of meaningful production in its current configuration or state of completion.
    - This was differentiated from *Bearspaw* where the well was capable of immediately producing NG, but there was no pipeline available to allow for its transport.
    - Bearspaw also used the term producable rather than capable of production

Ratio: "Capable of production" includes at least the ability to bring a meaningful amount of NG to market without having to conduct additional wells etc.

- PAGE 193: In the case of a marginal well, whether: reasonably prudent operator would continue to operate for the purpose of profit?

NOTE: The use of the word "producable" is much less common in Alberta law, capable of production (*Omers*) is much more common and therefore it is the conclusion from this case that would be the focus of most analysis's.

(3) THE SHUT-IN WELL CLAUSE

- **Shut-in Well Clause:** Permits the lessee to shut in the well, thereby ceasing "actual production", and paying a fee to the lessor to create "deemed production", with the ultimate goal being the lease continues to be valid
    - Payments must be made to the lessor <u>by the anniversary date</u> of the lease. Deemed production can only be achieved by the timely payment of the SIR
    - This is an option of the lessee to continue the lease if he chooses, NOT an obligation.
- Once a well is producing and the habendum conditions have been satisfied, there may still be times where the well is not in a position to produce. Examples of reasons accepted to shut-in a well are:
    - A lack of market
    - An intermittent market
    - Causes beyond the lessee's control, OR
    - Good oilfield practice (broad, left open to interpretation by the court)
- NOTE: The ability to shut-in a well in accordance with the lease will <u>depend upon the actual wording of the lease's shut-in well clause</u>
- Highly situational → dependent on the facts (intermittent market, causes beyond control, GOP)
- (lack of market, an intermittent market, or causes beyond the lessee's control, good oilfield practice)
    - **The onus is always on the lessee who wants to shut in to prove that they fall within the proviso** to excuse non-production (ie. that the well is shut in for one of the 4 reasons above)
    - Durish, Teg and Freyberg are a trilogy of cases where the lessee claims to be shutting in the well for one of the 3 valid reasons included in the SIR clause, but they are really doing so for their own convenience, and the court denies them the use of the shut-in well clause
        - In Durish, they claimed that their actions fell within "good oilfield practice"
        - In Teg Holdings, they claimed shut-in the well due to causes beyond their control
        - In Lady Freyberg, they claimed that there was no available market

Kissinger Petroleums Ltd. v. Grover (1983) ABQB [**SIR MADE IN ADVANCE AND IN CONTEMPLATION OF A SHUT-IN IS VALID]**
Facts: Kissinger was drilling at the end of the primary term, and there lease was extended by operations. They were worried that operations would result in a capped gas well, so they sent a cheque to the lessor saying the cheque was an SIR payment. They finished operations and shut the well. The cheque was received before operations ceased.
Issue: Can the payment of a SIR be made in advance?
Held: Yes. An SIR payment made in advance and in contemplation of a shut in well does not impair its efficacy as a royalty payment.
Analysis:

- Kissinger addressed the "fatal gap" danger by paying the royalty in advance in anticipation of operations ceasing.
- In contrast, in *Hambly* there was no timely payment of the SIR, and there was a 5 day gap between the operations and production, so the lease died. Hambly dealt with deemed production.
- Also in contrast, in *Cull* the lease was extended so long as the well was brought into production within reasonable diligence and dispatch. Cull dealt with actual production

Take Away Point: There are many leases today that have been shut-in for a long time, but the lease will NOT be extended UNLESS the requirements of the shut-in clause are met, namely, the SIR payment.
Key point: Points to the difficulty of getting deemed production. Lessee was smart and sent the SIR cheque before they actually shut in the well. Court said this was fine even though a lessee may not know ahead of time whether they qualify as having deemed production. In addition, the SIR in this case had a clause saying you simply must not have abandoned the well in order to validly shut-in the well (a very easy threshold to meet)

The Trilogy

Durish v. White Resource Management Ltd. [**WHAT IS GOP? → 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 dispute w/ another party over costs of transporting the gas, so shut in the well. Because the lease was extended by production beyond the primary term, W (the lessee) argues that the terms of the habendum relating to non-production for any cause whatsoever which is in accordance with "good oilfield practice" applies to this dispute and that the lease is therefore valid and subsisting. In the alternative, W argues that they have paid the SIR, albeit late. In the further alternative, W argues that they were entitled to notice of breach of K.
Issues: (1) 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? **(2)** Is the payment of SIR's 7 months after production ceased a reasonable period of time? **(3)** Is the payment of SIR an obligation under the lease such that W was entitled to notice of breach?
Held: No; no; no.
Reasons:

- (1) Does shutting in the well over a dispute over the payment of processing fees fall within the ambit of **"good oilfield practice"**?
    - A contractual dispute between the farmor and farmee was not a sufficient reason to shut in the well. Since the shut in was invalid, and the production period ceased for 90+ days, the lease expired
    - Remember, the classic reasons for shutting in a well are: **(i)** lack of or intermittent market, and sometimes **(ii)** events beyond the control of the lessee.
        - Doesn't include how much the processing fees
- (2) Was W's late payment of the SIR sufficient to extend the lease?
    - The lease indicated that if there was no production for 90+ days then the SIR must be paid at the expiration of the year. The court interpreted this to mean payment on the anniversary date or within a reasonable time before or after such anniversary date.
    - Here, anniversary date of the year in which production stopped was May 27, 1986 and payment was made on January 17, 1987
        - On Jan 16, 1987, White mailed $1070 to the lessor stating that this amount represented shut in payments regarding the anniversary periods ending May 1984, May 1986 and May 1987 by letter dated January 28, 1987.
        - Can't make the back payments like that, fool!
- (3) Was the lessee entitled to a notice of default when he failed to pay the SIR?

- Payment of the SIR is NOT an obligation; rather it is an option/privilege open to the lessee to continue the life of the lease if he so chooses. An obligation is something that you are required to do.
    - Here, if the lessee fails to pay the SIR, there is no requirement that the lessor inform him, since there is no breach. In the event of non-payment, the lease expires.

NOTE: The court softened the payment provision of the SIR, holding that payment can be made within a "reasonable time either before or after such anniversary date. Did so on the basis that the "at" in "the lessee shall pay the lessor at the expiration of each such year…" is imprecise and only means nearness and proximity and therefore denotes a reasonable time.

- Again, more "liberalization" or loosening of the Martland days of strict construction (*Cull*, *Crozet*, *Durish*)

549767 Alberta Ltd. v. Teg Holdings Ltd. (addresses whether the lessee fulfilled the SIR clause → **[IF THERE ARE OTHER OPTIONS AVAILABLE TO THE LESSEE, THEY WILL NEED TO EXHAUST THOSE TO FALL W/IN GOP]**)
Facts: Lessors (the number company) had two leases with Chevron. Chevron reserved a 15% overriding royalty in both leases and assigned the rest of its interest to Telstar. Subsequently, Teg acquired Chevron's overriding royalty interest. Telstar was the operator of the lease from 1976 to 1994. Telstar then quit and claimed its entire interest under each of the leases to Teg. For 20 years the well remained shut in on the alleged basis that there was no available transportation or markets for the gas.
Issue: Were the wells "shut-in, suspended or otherwise not producing as a result of, a lack of or an intermittent market or lack of transportation facilities or any other cause whatsoever beyond the control of the lessee?"
Held: No; the lessee could have applied to the ERCB for an order to declare a pipeline a common carrier, and an order to declare the processing plant a common processor.
Reasons:

- The onus is always on the oil company who wants to shut in to prove that they fall within the proviso to excuse non-production
- Here, the nearest pipeline was only 3 miles away from the wells, which would have had capacity for the lessee's gas
- They could have negotiated with the carrier or applied for a common carrier
- The processing facility had the capacity to accommodate the lessee's gas, and there was a market for the gas
- With regards to the lack of market, the court held that at some point during the 20 years there would have been a market
- Bottom line: They did not fulfill any of the requirements under the SIR clause
- The real reason there was no production is because the well was overencumbered. They lessee would have owed 1 15% royalty to the lessor and another 15% royalty to a different oil company. It would not have been worth it for them to produce

Key Point: A lessee has a fairly strong onus to prove that the reason to shut-in the well is actually outside of their control. The court will not allow a lessee to avoid production (i.e. keep a subsisting lease) simply because it is not commercially favorable to their own interests (for reasons outside of general market conditions)

Lady Freyberg v. Fletcher Challenge Oil and Gas Ltd. [OBJECTIVE TEST FOR PROFITABLE MARKET; BUSINESS JEDGMENT RULE TOO SUBJECTIVE → BASED ON INFO AVAILABLE, WOULD A PRUDENT LESSEE HAVE FORESEEN PROFITABILITY; CAN'T JUST SIT ON A WELL]
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 a period of 20+ years, citing a lack of market. When the well was finally put to production (1999) the plaintiff's well-head the highest level of production in the field. The lessee claimed that there was no economical or profitable market. In reality, they only had a 25.83% interest in that well, and they had another well in the field with a 51.66% interest. Therefore, the lessee could increase their return by increasing production from one of the other wells and drain the pool.
Issue: Did the lessee have reason to shut-in the well due to the lack of an available market?
Held: Not on these facts
Reasons:

- **Test:** Would a prudent lessee based on the information that they had available at the time have forseen profitability. This is an objective/subjective standard, as a prudent lessee is determined on an objective basis by the (1) character and nature of the lessee and (2) the reasonable expectations of the parties
- Onus is on the lessee to show that he can shut in the well pursuant to the terms of the lease. Evidence proved that there were lots of good markets for gas during those years, especially because the lessee was producing from the same pool with a different well

- This principle is similar to *Durish* (K dispute with farmee 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 Enregy 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 <u>DURING THE SECONDARY TERM THE WELL WAS SHUT IN FOR GOP;</u> 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 to limited the circumstances that would allow for the shut-in of the well.
Issues: Did the shut-in provisions of the lease (i.e. subject to good oil field practice) allow the shut-in in this situation?
Held: The clauses of the lease must be read seperately.

5. Operations Under an Invalid Lease

Champlin Refining Co. v. Aladdin Petroleum Corp. (1951) Oklahoma [THIS WAS A MISTAKE, NO MALFEASANCE; ACCOUNT FOR PROFIT, BUT DEDUCT COSTS OF PRODUCTION → TO NOT DO SO = UNJUST ENRICHMENT]
Facts: Champlin leased land from the state of Oklahoma. Had a whole bunch of opinions that they were getting good title to the lands that they bid for in the auction. Back at the time of this case, the government did not guarantee title (ie. as far as we know we are the owners of this land). C drills two successful wells on the land. To its horror, sometime later they discover that the lands are not theirs and they belong to Aladdin and Phillips.
Response: What does Champlin do to the injured party? Paid out all of the proceeds of production minus the cost of production (net proceeds), and handed over the wells.
Issues: (1) Is A entitled to the highest MKT value in conversion? (2) Is C entitled to offset the claim with reasonable costs of production?
Decision: (1) No, they waited too long (2) Yes, or otherwise it would be unjust enrichment. Paying net proceeds = appropriate.
(1) Conversion claim
    - Applied a principle from conversion, arguing that they might have produced oil at that rate.
    - Recall: *Asamera Oil v. Sea Oil*: Can recover fluctuating value @ highest value reached during time of conversion
        - Asamera lent shares to Sea Oil at 0.29/share. Sea Oil was supposed to return them but did not. Highest amount achieved was $46.50/share
            - SCC said mitigate or litigate (must energetically pursue L) at the time of conversion

Why did Aladdin not get this remedy? If you are seeking this extraordinary remedy, it gives you the power to speculate. <u>You have to litigate promptly and pursue the litigation energetically</u>.

- **NOTE:** ABCA not willing to call the w/d of oil from the ground as a form of conversion b/c req possessory interest
    - AB doesn't recognize possessory interest until captured, not in ground.

(2) Offset claim
    - The court <u>subconsciously applied the law of unjust enrichment</u> to determine what the increase in value of the improvements to land were
        - Good Faith trespasser & would result in a windfall for the Plaintiffs.
        - Higher levels of compensation are the defer people from continuing.
    - Normally an unsolicited intervention with land does not give rise to compensation to the trespasser, however, if the following are met the intervention will be compensated:
        - (i) <u>Unofficious intervenor</u>
            - The trespasser must have an honest belief that he owned the land
        - (ii) <u>Incontrovertible (not able to be denied) benefit</u>
            - Where a victim can reasonably show that they would not have wanted the benefit (ie. a garage on their ppty), they will not be forced to pay for it.
                - Here, A as an oil company would have incurred the costs of production because they are an oil company
                - And they definitely wanted the oil out of the ground.

- How can this happen today?
    - Used to happen a lot that people trespassed on other people's OG because of improper surveys. Two common ways:
        - (1) Do not have right title (*Champlin v. Aladdin*)
        - (2) Most common: You are under a lease which you are sure is valid, but unknown to you the lease is expired for some unexpected reason (*Weyburn*)
- DP: remember the principle of C v. A. when we look at unexpectedly terminated leases.

Key point: Conversion is an unlikely remedy for OG in the ground in Canada. Why? Difference between recognition of OG in situ (which we have) vs. recognition of possessory interest in the OG under your land (which we do not have)

Modern Unjust Enrichment

- The preceding discussion concerned the emerging doctrine of UE. From 2004 onward, the **courts seem to have forgotten about UE and switch to tort as a solution to the same problem.**
- How did the courts view the remedy of the lessor in the face of the trespassing energy company?
- Next three cases show a different approach from the courts, where the lessor gets a royalty (*Freyberg v. Fletcher*, *Montreal Trust Co. v. Williston Wildcatters*, *Xerex Exploration v. Petro-Canada*)
    - The courts switch from UE to tort. How can we compensate you for the wrong that occurred while you were exploiting oil under an invalid lease? How do we put you in the same position as if the trespass had not occurred?
        - DP: instead of giving the proceeds of production, return to the date of the trespass. On that day if the energy co left the land as it should have, what would you have done? You would have entered into a new lease with another company. What would the terms of those leases have looked like? Not only would the oilco not be incurring risk (it knows the proven reserve) and it does not even have to drill a well!
        - Court: very advantageous bonus, and very generous royalty rate on production
        - What inspired this? (ie what inspired the move away from *Champlin* and *Sohio*)
        - Courts say that it would be too much to give you the proceeds of production – minus costs of production
            - ie. Lady Freyburg wouldn't enter a production agreement herself, and she couldn't (lease was also co-owned by NV), she did not have a licence, etc. But she would have gone in and negotiated a new lease, and that is what she would have got if oilco was not trespassing
            - ie. Montreal Trust/Lewis. Why cast in Lady Freyburg mode? Montreal Trust was a bare trustee, they had no right to produce. Had no right to produce the well themselves
        - Bottom line: Courts have changed the game from UE (*Champlin/Sohio*) to ordinary tort principles.

NOTE: Even with tort principles, a bad faith/mala fide trespasser may be required to disgorge profits (bonus pt here I think)

***Weybern v Sohio*:** Kinnimouth problem. Produced Oil for 12 years. [**COURT WAS GUIDED BY EQUITY → ONLY HAD TO ACCOUNT FOR BENEFITS REALIZED THROUGH PRODUCTION ONCE THEY WERE MADE AWARE OF THEIR MISTAKE (WRIT OF SUMMONS)]**

- Trespasser entitled to keep profits up until statement of claim was served.
- Up until the time the statement of claim was filed b/c until then they weren't making profit. Once they made a profit, the court felt it was fair to give funds to true owner

WIllston Wildcatter v Montreal trust **[COURT IDENTIFIED TWO MODES OF RESTITUTION—HARSH AND MILD—SAID MILD WAS APPROPRIATE]**

FACTS: Wildcatters produced oil for 10 years on lands owned by BoM without a proper lease in place. Court does not award the net proceeds of production because BoM had no intentions of setting out and drilling/producing from a well on the land. They lacked both the legal ability (as they held the land as a trustee for the true owners) and practical ability.

RULING: Damages = **Compensation based on royalty it could have collected.**

- **There were two options:**
    - **Harsh rule:** full disgorgement
    - **Mild rule:** mild disgorgement or **royalty payments**

ANALYSIS:

- BoM would have leased it out from a good bargaining position
    - (as Wildcats activities on the land may have made it look more appealing to others),
    - and so the court looks to how much royalties and bonuses they would have received
- Damages should be the difference between what Wildcats paid and what they could have received instead as this would put them to the exact position BoM would have been in.
    - It would be a massive overcompensation to give the proceeds rather than the revenue
        - **the problem with full or partial disgorgement is the lessor would never have received full proceeds from the well → awarding damages in this way would return them to a better position than they would have been otherwise**
    - What did BMO lose? An opportunity to re-lease their lands to someone else.
    - Under the Wildcat approach, can still get the net proceeds of production if the lessor was, say, another oil company
    - **But the problem with the mild/royalty+bonus approach is an innocent trespasser benefits from a lease they never contracted for**

NOTE: If the BMO had been an oil company, rather than loss of royalties, the net proceeds may have been appropriate.

***Lady Freyburg* [APPLIED *WILDCATTERS* AND AWARDED THE MILD FORM]**

FACTS: As above

DAMAGES: similar to that of BMO – could not extract the oil herself

- HOWEVER, her well was shown to be very productive, and she could've gotten a really good royalty rate
    - Very generous damage award based on excellent bargaining position
        - Assessed based on the agreements in place with neighbouring wells
- Also ruled that D's was not sufficient to warrant disgorgement
- **Allowed damages flowing from conversion, but not trespass (odd)**
    - Compensatory, not restitutionary

Xerex v. PetroCanada (2005 ABCA)(compensatory approach) - Main difference, oil company lessor, unlike most has the ability to operate the lease themselves → **[THERE WAS A MISREP AND BREACH OF FIDDUT → APPLIED THE MILD APPROACH, EVEN IN THE FACE OF THIS BEING A CASE WITH TWO O&G COMPANIES AND THE ACTIVE BAD FAITH]**

Facts: AB government owns mineral rights in a layer cake. X owned deep rights, PetroCan owned shallow rights. PC was permitted to drill 15m into the deep zone for the purpose of storing drilling tools (called an "overhole allowance"). They decided to start looking around in the deep zone, which they were not permitted to do. They found very promising samples of oil, and tried to acquire the rights to the deep zone from Xerex without telling them that they had taken samples. X entered into an agreement with PC that entailed a 2% GORR royalty. X did not receive any royalty cheques, even though oil was being produced by a company that was sold the rights from PC (X did not know that oil was being produced). The Oilco took $16.2 million. In summary, PC knew the deep zone had lots of oil, and they acquired the right through a breach of fiduciary duty (to the court) and misuse of confidential information. There was also a possible conversion. Situation basically screams bad faith trespass.

Issue: What should the remedy be? (i.e. what position would the oil company have been without the tort? In this case they would have simply drilled the well themselves).

Held: Xerex was awarded 50 percent of the $16.2 million.

Analysis: The ABCA took a compensatory approach, and asked what type of deal would Xerex have entered into if PC hadn't misused confidential information and breached their fiduciary duty.

- In America, PC would have been treated as a bad faith trespasser, and would have lost the entire $16.2M
- ABCA: PC using wrongfully obtained information, damages were awarded at half of the $16.2M
    - DP: What was the rationale? It appears that the compensatory approach may here give rise to almost a to lenient approach to damages (DP: conduct was outrageous damages should have been the full amount possible)
- **Had unjust enrichment been found, the result would have been radically different**
- Also a breach of fiduciary duty: PC
- Should have applied Disgorgement
    - Why was this difficult?

Conversion: It is difficult in these types of cases to even know what tort action should be plead

- Conversion deals with interference to goods and chattels, NOT land. To be able to sue in conversion a plaintiff must be in possession of those goods and chattels, or have a right of immediate possession. There is a real question, therefore, whether the holder of a mineral rights licence, who has not yet exploited his interest, has an immediate right to the possession of substances that have not yet been severed from the ground. This is an unsettled area of the law, and because the TJ did not award damages for conversion we see no reason to consider this issue further."

Sidenote: The well of Xerex was set to expire December 3, and they did not reach the agreement with PC until November 22 in a remote part of AB. Since PC already had a rig on site, it made sense to sign an agreement with this company. DP thinks that this was in the back of the courts mind when they awarded half the value (i.e. rationale that Xerex's lease would have likely expired).

- Theoretically the court should have awarded the full 16.2 million. BUT since PC had also sold the rights to drill to a third party (for $850k) disgorgement of what PC made would have been insufficient. This made the appropriate award in Xerex difficult to achieve.
- The court's rationale seemed to be that if Xerex knew about the potential success of the well, they would have entered into a 50/50 farm out with PC (and in turn been entitled to 50% of the proceeds of the well

Measure of recovery of unjust enrichment

- What did the lessee gain from the wrongful occupation of the P's mineral estate? Free occupation of land that would otherwise have been paid for
- **Disgorgement of profits required only if D was "consciously tortuous in acquiring the benefit**". This makes makes the result in *Champlin* and *Weyburn* unusual
- DP: fear that you have to be really bad to disgorge profits. Think about other areas: breach of fiduciary duty (*Xerex*); misuse of confidential information (*Lac*); conversion (see discussion in *Xerex*)
    - Breach of K would not require a disgorgement. Put the P in the same position as they would have been had the K been properly performed (i.e. restitution)
- **Key point: UE remedy will not look like the remedy in *Champlin* and *Weyburn*. Since 2004 courts have been applying *Wildcatters* and *Freyburg***

Measure of Damages – Generally, appropriate damages are compensatory for position could've had.

Good Faith v Bad Faith

- **Bad Faith**: Measure of production would have been the value of the oil but they would not have been allowed to deduct. This higher level of compensation's function is to deter others from doing the same thing
    - DP: Basically a hidden punitive award, as the court would not draw specific attention to it, and use the proceeds as a means of measuring approximate value.
    - ***The "Harsh Rule" – may be the proceeds of production*** → **harsh rule used in lieu of punitive damages**
        - Used to discourage producers from taking advantage of MM owners.
        - Punitive trespasser damages happen to be equivalent to disgorgement of profits
    - Indicators of Bad Faith: breach of fiduciary duty; misuse of information; active misrepresentation
- **Good Faith**: The method used here could be used for those instances where a lease is discovered to be bad years later.
    - This case is an example of waiver of tort (see American seismic exploration case (Phillips Petroluem v California Std)). Waive tort and seek to receive benefit lost.
    - Also implies unjust enrichment: making sure that the wronged party is not unjustly enriched
- Criticism of compensatory approach (five arguments against *Freyburg*).
    - 1) It is Inconsistent with most OG authority (Bankes and DP strongly agrees)
    - 2) LF and Wildcatters. The trespassor still receives some measure of profit. **Tortfeasor should not profit from a wrong (Ballem)**. Measure of damages is **speculative** and fails to reflect the lessor's property rights, ie. let's pretend that you had a negotiation. Here's what the outcome is likely to have been.
    - 3) Different measures apply to different lessors
    - 4)No disincentive to production under challenged lease
    - 5) Trespassing oilco continues to produce under the challenged lease. They know that they are going to get costs of production and likely something else

Comparison of Damages: Look @ Tort or Unjust Enrichment.

- Champlin – profit stripping w/o bad faith; pretty harsh
  - Treated worse than other people in their position
  - Generally reserved for faithless fiduciaries
- Seismic Case: not concerned w/ how much was made by geo-exploration, but with damages suffered
  - There was no bad faith or anything of that nature—hapless accident; only awarded compensation for the damage to the well
- BMO v Wildcats: entitled to what royalties they may have procured.
  - Profit stripping would be inequitable to put BMO in a position better than they could have reached
  - **But it allows a tortfeasor to profit**
- Weyburn v Sohio: 70/30 split of profits – all those after the statement of claim was filed for 12 years of work
  - Wanted "just and equitable compensation"
  - Cannot get the benefit of money w/o paying the costs.
  - **Only awarded from day the writ was served → deemed knowledge of the tort**
- Freyberg: Royalty she could have received, which likely would have been really high
  - Some evidence of bad faith (tried to lie to her), but not enough to warrant disgorgement
    - **We need more guidance as to what would constitute punishable faithlessness**
- Xerex: Compensated for 50% of profit b/c could've easily entered a 50/50 farm out agreement
  - BUT, DP says they were way too lenient. **There was serious bad faith on the go.**
  - Petro Canada had wrongfully obtained information which they didn't share with Xerex prior to entering into negotiations. There was a fiduciary relationship between the two. DP: there may have been a too lenient approach to the damages awarded.

Seems to suggest a compensatory remedy under an invalid lease. Negotiating a royalty of whatever the market would have paid. What of the situation where the lessor and the lessee are Oil Companies?

- Arguably, it's net proceeds – might plausibly say "we would've taken over the well and produced it"
- It's the same level of damages for disgorgement, but look at it from tort perspective & future income damages: a lot higher for a 27yo neurosurgeon than for 65 yo homeless person.

The remedy would be achieved either through UE or tort, with tort being the easier to reach and would be more generous than mere restitution.

- Some cases say can't do unjust enrichment, but looking at UE in a limited sense: that the drillers should be stripped of profits

Unjust Enrichment

- Unjust enrichment has three elements:
  - Deprivation
  - Corresponding Enrichment
    - What Benefit received w/o paying? Generally: continued use & occupation
    - Remove the fact that landowner can't operate themselves: still a trespass, and the landowner could get another party to do the work at a better rate if it's a good lease.
  - Absence of juristic reason for the corresponding enrichment
- An unrequested benefit can be found with free acceptance *(Weyburn)* or through an incontrovertible benefit0
  - Ex. Say you wrote down the wrong tax number when you paid your taxes. You will have satisfied an obligation that the other person was bound to pay if you hadn't done it for them. Never requested, does not involve direct payment of benefit, but this is an incontrovertible benefit
  - Should have to pay for this in OG b/c there's no reason you wouldn't want to drill and produce your PNG

Sohio Petroleum Co. v. Weyburn Security Co. Ltd. (1970) SCC (Kininmonth problem; argument that the lessor is estopped from denying the validity of the lease; remedy of unjust enrichment, **BUT DONE WITHOUT SAYING AS MUCH**; **ESTABLISHES PRINCIPLE THAT DAMAGE AWARDS NEEDS TO BE FAIR AND EQUITABLE → NOT REALLY A GUIDING PRINCIPLE**)

Facts: S began to drill a well 1 week before the expiration of the primary term of their lease, and completed the well after the expiry of the primary term (simple Kininmonth problem). S felt that because of their amended continuous operations clause, the lease would not have expired. However, their COC almost restated the COC in *Kininmonth* – the clause required that there already be production at the end of the primary term. Here there was no production until after the expiration of the primary term, and therefore, the lease expired on the 10 year anniversary.
Issue: Are there grounds for a promissory estoppel argument? How does the court provide justice to the parties?
Held: There were no grounds for promissory estoppel. Justice was granted in the form of unjust enrichment
Reasons: "Subconscious" Unjust Enrichment

- Not fair to kick lessee off of the land. The solution here was for the lessee (Sohio) to keep all of the proceeds up until the point that the action was started. After that, the lessor will receive the proceeds.
    - The lessee spent money in producing the oil, so it would be unfair to not give them some of the profits
        - Why? Unofficious (i.e. unaggressive) intervenor, incontrovertible benefit.
        - (1) Unofficious intervenor: Lease had mistakenly come to an end, and OilCo did not knowingly take advantage of the lessor's lack of appreciation of its legal rights
            - The lessee proceeded under a mistake as to its rights, and <u>did not knowingly take an unfair advantage</u> of the lessor's lack of appreciation of its legal rights
        - (2) Incontrovertible benefit: As an owner of a mineral estate, the lessor would have inevitably produced the minerals, as such, the lessor cannot argue that he would not have drilled the well
            - (1) deprivation: S built the producing well
            - (2) corresponding enrichment: W was enriched because they have a producing well on their lands
            - (3) absence of juristic reason: as soon as the lease expired there was no longer a juristic reason for the enrichment (i.e. S would not have drilled the well if they would have known that the lease was expired)
- Why is the calculation done on the date of the writ? The lessor is arguing that accounting should be calculated from the date the lease terminated, subject to an allowance for expenses incurred by the OilCo
        - At the time the action was commenced (writ), the revenue exceeded the amount of their expenditures
        - This date unjustly enriches the lessor at the expense of lessee. Why? Lessor had a royalty agreement. An accounting, like in *Champlin v. Aladdin* would give the lessor more than they had bargained for or would have bargained for in a new lease.
            - Can avoid this by taking the date where they broke even, which happened to occur prior to the date of the writ.
                - See *Champlin v. Aladdin*, true owner of the land got the proceeds of production less the costs of production, not the case here
                - **Good faith trespasser:** Gets the proceeds of production less the costs of production
                - **Bad faith trespasser:** Must give up the proceeds of production, but may be able to receive an accounting for their costs (*Lac*)
                    - In effect this is a punitive measure, you must give up everything which seems dedicated to punishing the wrongdoer
        - Key point re: date: SCC calculates UE at the time the action was commenced. *C v. A*, which is an Oklahoma case calculated it as revenues – costs of production. Be sure to use SCC formula.
            - Main difference is that Sohio is able to keep some profit
    - NOTE: Every one of these cases has the potential for UE, but this is the first time that it was raised albeit "subconsciously".

Republic Resources Ltd. and Joffre Oils Ltd. v. Ballem (1982) ABQB (Unjustly enriched lessor)
Facts: A well was drilled near the end of the primary term, and was completed after the end of the primary term. After the primary term had ended, natural gas was discovered in commercial quantities and the well was prepared by the lessee for production and capped for lack of a market. But what about the 188K oil & gas well we left you? Lease died b/c production didn't extend.
CONTINUOUS OPERATION CLAUSE: "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."

- The lessee argued that the italicized portion allowed them to continue operations past the primary term, but it did not remedy the fact that the habendum requires production in order to extend the lease past the primary term. Instead, what it does **is allows a grace period if production ceases after the lease has been extended. → need the production first**
- The result is that this lease is dead under the Kininmonth problem. The only complicating factor was that the parties included another saving clause. 30 days to renew the option after its termination
- Ballem (lessor) became aware of the invalidity during the 30 day option period, and waited to challenge the lease 36 days or so after the end of the lease
- Republic is kicked off the land, but what do they say on their way to the exit?
- Want the money for the well they drilled, ie. pay the drilling costs

Issues: (1) Were the lessors under an obligation to inform the lessees of the invalidity? **(2)** How did the court provide justice to the parties?

Held: The lessors were not under an obligation to perform; and the court consciously addressed unjust enrichment.

Analysis:

- **Unjust Enrichment** (addressed more consciously by the court, yet still not thoroughly)
  - OilCo asks for $190K in restitution for the cost of drilling the well
    - (1) Unofficious intervenor: Satisfied. OilCo mistakenly let the lease expire, and did not blatantly exploit the B's rights
    - (2) Incontrovertible benefit: Not satisfied here. No free acceptance as in *Weyburn*, where the lessee had knowledge of the ongoing operations and accepted royalties. Rather, in this case there is an unascertained benefit conferred on the P. This well was in close proximity to 13 other capped gas wells thereby casting doubt on whether the costs of drilling the well are proportionate to the "benefit" conferred on the B's. There is no authority for the court to impose a lien/charge against the future net proceeds of production to offset the costs of the well. The OilCo took a calculated risk by starting drilling late in the lease
    - Would be forcing them to pay money for oil equipment that it not providing them a benefit
      - Mistaken improvement to property.
      - They never asked for this well.
  - DP: This leaves the lessors unjustly enriched, and the court decided this wrong.
  - All they have to do is turn on the well, and they get all the fruits of the labour for nothing
  - **There could be an option to argue for an equitable lien registered against title to reflect the value of their work**

International Corona Resources v. Lac Minerals Ltd. (1999) SCC COMPENSATED FOR VALUE OF THE IMPROVEMENTS, SUBJECT TO DEDUCTIONS)

Facts: D built a mine for $200M. Section 37(1) of the Conveyancing and Law of Property Act indicates that a person who makes improvements on land that he honestly believes he has title to will be compensated for the cost of those improvements if the title is successfully challenged. The word "belief" means an honest and bona fide belief. The reasonableness of the belief must be considered on an objective basis. Lac's testimony is that it held an honest belief that it was the valid owner of the lands. This is reasonable - why else would they spend over $200 million developing the mill and mine? *cf. Scurry Rainbow v. Taylor*: another case with breach of confidence

Issue: What compensation, if any, should Lac receive for its costs of developing the property, including the cost of the mill and mine, even though they misused the information in the first place?

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.

Reasons: In giving up the ppty there are lasting improvements that benefit the true owner of the ppty. We have to ask how they get compensated for that…very controversial in Canada. Corona testifies that it would have been able to develop the property more economically had it been the owner. Therefore, Corona contends that it should not have to compensate Lac for the full cost of Lac's improvements. Judge finds that Corona would not have developed the additional mill for $85 million. Therefore,

Corona must pay Lac the cost of the improvements, minus the superfluous upgrades it would not have otherwise made, in order to restore Corona to the position it would have been in had it been allowed to develop the property itself.
Note: Lac is not trespassing *per se*. Lac had good title to the property, but the court found that Lac acquired the property in breach of confidence and that therefore they were actually holding the property in a constructive trust in favour of Corona.

- Also, if you look at this case in the 3rd para., there is a remnant of old CDN statutory law which is found on the prairies…
    - "Called improvements made under mistake of title" *cf. Republic*
        - Where a person makes lasting improvements on land under the belief that it is his own, he or his assigns are entitled to a lien upon it to the extent of the amount by which its value is enhanced by the improvements…"
        - DP calls this statutory unjust enrichment action; result could not happen under the CL
            - Equitable remedy
                - The Act was enacted in response to a social problem of settlers who sometimes built their homes on the wrong plot of land. This would not be an incontrovertible benefit.
                - MM/OG mistakes were not social problems, but this case found the Act to apply

Stewart Estate v TAQA North Ltd

- **trespass and conversion are applicable to mines and minerals rights**
- problem: was the lessor ever in possessory right? → uncertain
- 3 different decisions → only point of contention is that the lease terminated

Facts:

- 5 leases; all important because together they formed a DSU and were part of a pooling agreement
- 3 were found invalid because they were capped due to abandonment, not lack of market
- post-expiry, there was a license granted for a reworking
    - but still there was termination
- court seemed to agree the appropriate cause of action was trespass
- **trial judge used royalty plus bonus approach**
    - On appeal, Court held the mild restitutionary form of damages (partial disgorgement) was appropriate

Decisions:

- Rowbotham J: use a restitutionary form → partial disgorgement (mild)
    - **Harsh rule (full disgorgement) no longer exists**
    - Believed the decision in *Sohio* upheld the mild rule
- MacDonald: wanted a harsh damages award (full digorgement)
    - There was no good faith when the well was recommissioned, and as such they should be subject to the exact remedy upheld by the SCC in *Sohio*
    - *Sohio* endorses the harsh rule in the situation because there was no good faith
- O'Ferrall:
    - We should follow *Sohio* → appropriate measure for damages for wrongful production following the termination of a lease may vary with the circumstances, I articulate no general principles here
        - HUH??

Summary

- **First, we had in the early years a whole group of cases where the lease unexpectedly terminated, a well had been drilled, but there had been no production from those wells**
    - The universal result is that the lessee is ejected from the land and **receives no compensation** for any improvements that had been made to the land. This is the law as it stands today *(Kininmonth)*
    - *Republic* was the first case where it was argued that there should be some compensation payable to the lessee on the grounds of **unjust enrichment.** While the argument failed, DP thinks it should be raised again
        - The lessee has left the land with an improvement on it (completed gas well), which is an incontrovertible benefit to the lessor, just as the gold mine and mill was an incontrovertible benefit in *Lac*
            - **If we get UE re Mines, why not O&G?**
        - The day the lease fails and the lessee is kicked off the land is the day that the enrichment occurs

- **Second are the cases where a lease terminates leaving behind a producing well (more common)**
    - *Weyburn v. Sohio*: This was the first case where subconscious unjust enrichment came up. The lessee was allowed to keep the proceeds from the well up until the point the lessor filed the statement of claim and the action was commenced. The intention of this was to allow the lessee to recover the costs of drilling
        - It would be unfair if the lessor was to receive all the proceeds from production, and this remedy ensures that at least the lessee is compensated for the costs of bringing the well into production
    - *Champlin v. Aladdin*: A well was drilled under mistake of title, and the lessee received costs of production. Canadian law is similar to American law on the subject, with the exception of the "bad faith trespasser" law in the US, which requires the lessee to give up all proceeds of production.
    - **Compensation Approach:** In 2004, the law in Canada changed with *Williston v. Wildcatters* and *Lady Freyburg*. In this scenario, the **court will now attempt to put the plaintiff (lessor) in the position they would have been if the tort had never been committed**
        - This threw unjust enrichment out of the door for now, and changed the approach to tort. However, there still are 3 potential sources of remedy that the plaintiff can seek: (1) breach of contract; (2) tort of trespass; or (3) unjust enrichment.

- **DP thinks the unjust enrichment argument should be made again**
    - With unjust enrichment, the main question is how much was the lessee enriched by their wrongful occupation after the lease ended? Essentially, they occupied land for free when they should have been paying for it.
    - Forcing them to give up even the net proceeds of production is a very unusual remedy because that remedy is called "disgorgement" (ie disgorge the profits that you earned from the land). Disgorgement is only applied in the case of bad faith trespassers, breach of fiduciary duty, misuse of confidential information
    - If there was no bad faith, the extent of the production (ie. the profit that the oil company made) should be irrelevant. The question should be what would they have paid to be on the land?

- MAIN POINT: In all Cdn cases except sohio and weyburn it was assumed that the trespassing lessee lost everything. Lac shows us that this should not be the case, it may be a future/deferred benefit that hte lesser is receiving. The lessor should not have to pay immediately for that benefit, but should be required to account for the investment that the lessee has made when production begins (i.e. *Lac* required the value of the gold to be split)
    - It would be unfair to have her write a cheque because she has not realized a cash benefit and would be at a loss
    - Really, the question is about fashioning the right remedy – a matter of making her pay when the well is producing revenue.
    - Two suggestions from DP:
        - (1) Equitable lien
        - (2) Statutory lien. *Lac v. Corona* recall: 'improvements made on wrong land through error' (*LOPA* lien)
            - Section 69 *LOPA*: "When a person at any time has made lasting improvements on land under the belief that the land was his own, he or his 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."
            - *Lac* held that a "belief" is an honest and bona fide belief required by the equitable nature of the section

Despite the equity, *Lac* held that notwithstanding Lac acquired the interest under a breach of confidence, they were entitled to the statutory relief

Summary

- Reasons why leases fail:
    - 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. Williston Wildcatters Corp*)

- 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 (TL: and well) and receives 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 trespassor)
  - Milder result: in the absence of bad faith, the lessee must account for the proceeds received after writ (*Weyburn*)
  - Or net proceeds (*Champlin*)
- A (formerly) common rationalisation
  - In the case of good faith trespass the lessee accounts for production
  - No deduction in the case of bad faith trespass (*Champlin v. Aladdin* NTD: not sure why this is here, unless it was obiter)

POSSESSORY INTERESTS

DP: Questions about the possessory interest required for an action in conversion. What's the problem with OG?

- Recall: LMM held that there is a registrable interest in OG such that you have a:
  - (1) right to transfer title. We also know that in addition to transferability, there are two other ownership rights in the OG bundle:
    - (A) to exclude others from MM, and
    - (B) the right to use as one sees fit. Also, in *Texas Drilling Co*. We have DP's favourite description of the "ownership regime" in AB: Texas is an absolute ownership state, meaning that a landowner is privileged to sink as many wells as he desires upon his tract of land and extract therefrom and appropriate all the OG that he may produce.
      - Two limitations on ownership in Texas law are: (1) capture by your neighbor, (2) limitation by state police (meaning regulatory) power, including rules designed to afford each owner (a) a reasonable opportunity to produce his proportionate part of the oil and gas from the entire pool and (b) to prevent operating practices injurious to the common reservoir.
- Why is that not a sufficient possessory interest for conversion?
  - LMM: "The reason advanced for holding that OG are not minerals and not part of land capable of being transferred by one person to another by instrument is that they are 'fugitive and vagrant in their habits', and the surface owner cannot be said to have absolute property in them until he has mined them and reduced them to his actual possession and control. <u>*So long, however, as OG remain in the earth*</u> *they are an interest in land and belong to the owner of the surface unless excepted from his title, and he may transfer ownership just as in the case of other minerals*"
    - We do not say that they own the MM in the whole sense of ownership. (ie. not a complete bundle of rights), but we have *in situ* ownership of the OG
    - The rule of capture is relevant insofar as we can say that there is ownership of the OG once it is captured.
      - It is not <u>personal property</u> until that point.
- DP: So, following Champlin, would a CDN court be able to say that there was a conversion of OG where someone took the oil from beneath the land where they did not have rights?
  - One CA case (*Xerex* – Check) said that we never decided that. Reserved judgment to decide whether there was a sufficient personal property interest
- Trespassor in a case like Champlin has to leave the land and turn over the proceeds (ie. a clear case of unjust enrichment)
  - DP: I would doubt that the landowner has a sufficient possessory interest to support an action in conversion
  - DP: Ordinary remedy for trespass is the difference in value of land before and after the trespass (ie. Aliff)
    - How much was this type of land selling for before the trespass, and how much after the trespass – this would be a broad approximation

        - Conversion would not be a broad approximation, it would be a precise statement of how much OG was lost.
            - More precise justice as compared to rough justice of trespass

Why Estoppel Doesn't Work

- 4 Requirements of Estoppel *(High Trees)*:
    - (1) An unequivocal representation
    - (2) Reliance on that representation
    - (3) Detriment to such persons who relied on the representation
    - (4) Estoppel cannot be a cause of action/estoppel requires an existing legal relationship
- When you see the estoppel argument raised, there are 3 reasons why its not effective:
    - 1. If the lease is expired, they can't revive it. Can't create a K where there isn't one.
    - 2. Requires an unequivocal representation that you will not insist on strict legal rights
    - 3. Lessee is not acting on the representation of the farmer, but their own (legal team's) conclusions
- Desperately tring to argue estoppell to provent losing a profitable lease.

(6) The Royalty Clause

Acanthus Resources Ltd. v Cunningham (1998 ABQB) ["AT THE WELLHEAD = MARKET PRICE – DOWNSTREAM COSTS BORNE BY THE LESSEE]

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 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 AT THE WELLHEAD on the date of delivery

Issue: What is the meaning of market value **"at the wellhead"** and can treating costs be deducted?

Held: For the lessee treating costs can be deducted prior to determining market value at the wellhead.

- The market point for oil is not "at the wellhead" but rather downstream at an inlet terminal of a nearby pipeline (this is standard practice in the oilfield).
    - **At the wellhead is interpreted as the market price for oil downstream with <u>costs deducted</u> that should be borne proportionately between the lessor and the lessee**
    - This includes transport expenses and treating costs (i.e. costs to separate water from the crude)
- "A lessor's share is not subject to the costs of producing the substances and bringing them to the surface, but it is burdened with the share of the costs beyond this point"
    - A royalty is calculated on a net basis after these costs are deducted.

Ratio: Market price at the wellhead includes a deduction for <u>reasonable</u> costs incurred after the oil has been produced, but before it can be put to market.

- Price at the wellhead = price at which the gas was sold at the tailgate of the processing plant and deduct the costs that were required to get it to the tailgate

Canpar Holdings Ltd. v Petrobank Energy and Resources Ltd. (ABCA 2011) [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 land 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 17.5% royalty should be calculated on net saleable gas (i.e. at the time that it reaches the market) and no royalty was owing for the "fuel gas" that was used during operations. The lessor claimed damages for the unpaid royalty on the fuel gas, claimed that the lease was thereby void because of the breach and claimed a disgorgement of profits earned by the lessee during the time that the lease was void.

Issue 1: At what price should the royalty be calculated?

- Either the price received by the lessee (i.e. their hedged price) or the market value, whichever is higher
- Charging only the value of the hedged amount received was a blatant breach of the lease. Trial court very easily concluded that a substantial breach had occurred.

Issue 2: Was the fuel gas appropriately excluded in the royalty calculation? → **what volume of gas must the royalty be paid on**

Held: No, no persuasive evidence could be shown that a royalty was not owed on the fuel gas.

- It is standard that a lessee can use the gas produced for operations in regards to that specific well.
    - BUT Petro <u>by using the gas for compressor stations on **different lands**</u> was in breach of the terms of the lease.
- A royalty clause is specific on the method of royalty calculation, the amount calculated must properly reflect the agreement regardless of industry practice etc.
    - DP: Often breaches do not occur from bad faith, but just oil companies following industry practice that happens to be in breach of their current lease

Issue 3: What was the problem with Petro's approach?

- They argued that they were properly paying under the lease, and failed to rectify the lease in the 60 day grace period after receiving notice from Canpar.
- The royalty was owed on the full amount of gas produced despite any future refining etc.

Issue 4: What was the appropriate remedy?

- The lessor was entitled to the royalty, but the lessor WAS NOT entitled to the full disgorgement of the profits and the lease was not void due to the lack of payment
    - The continued payment of the lower royalty value made a finding of disgorgement incorrect (i.e. not operating maliciously from a high-handed position, continued to make payments throughout trial, we reasonable etc.)

- There was a huge disparity between the value of the property that would have had to have been forfeited versus the actual damages suffered by Canpar (DP: compensatory approach was correct)
- Shows the compensatory (modern) approach to deal with circumstances of a breach of lease

Chapter 5: The Nature of Royalties

(1) INTRODUCTION

Gas cost allowance: AB gov't regulation states in about 40 pages what rates can be deducted and the appropriate rates to this deduction. This is for gov't owned petroleum, but freeholders are left with the jumping pound formula.

Jumping Pound Formula: Take the tail gate price (ie. the price of the gas at the processing plant) and subtract costs of transportation and processing. Also account for the rate of return on the investment in the processing and transportation system.

- This is problematic now because the ERCB does not regulate this anymore, and therefore the operator can unilaterally determine what rate of return they want on their investments. The lessor gets a cheque but does not see these deductions
- Recall that a common processor can be requested by the lessor where a reasonable price must be charged.
- **Note:** The costs differ from oil to NG. Oil is sold pre-refinement, it only required minimal seperation costs and these were traditionally borne by the oil company.
- However, 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)
- May deduct any reasonable expense, including costs for water disposal, etc.
- *CF* Gas Cost Allowance for Crown Leases: regulations state what costs can be deducted & appropriate rates
  - Freehold lease: subject to the whims of producers & what they dedicde to charge.

NEW APPROACH: lease has an innovative solution to the deduction of costs by O and G companies. "In any event the royalty shall not fall below a specific percentage"

- The idea is that the lessee is allowed to make deductions, but in no event will the royalty payment fall below X percentage.
- The idea is that a lessee will be able to deduct costs, BUT a lessor will receive a guarantee that the lessee will not abuse their calculation of the deduction through a guaranteed minimum royalty.
  - Addresses squarely the problem of the traditional lease: the processing fee
- Clause 4 (proviso): can deduct these costs, provided the royalties shall not be less than X% had no costs been deductible.
  - Example: 18% royalty, but in no event shall the royalty be less 50% of the royalty had no costs been deductible.
  - Stipulates the type of costs, and an indirect cap on those costs
  - Quite happy to pay people when revenue is coming in, because there are heavy capital investments.
- NOTE: Geologists will often work on low base salary, but then get royalty in anything they discover something.

IMPORTANCE

- Royalty = cost-free share of production
- Royalties are important because the natural resources industry operates in an environment with high exploration and production costs and therefore people cannot always be paid by cash. It is much better to make payments out of the money that you plan on receiving in the future. For example, rather than saying drill a well at a cost of $X, say that you will pay X percentage out of the recovered substances.
  - Securities Act s. 1: A security includes any certificate of interest in an oil or natural gas lease, claim or royalty voting trust certificate; and any oil or natural gas royalties or leases or fractional or other interest in them. (i.e. a royalty IS A security)
  - Royalties allow campanies to pay once money is coming in from production.
- **Characterization of a Royalty:** The oil industry is dynamic and is characterized by frequent changes in land ownership, and oil companies are constantly going in and out of business.
  - If a royalty is a **contractual right,** it would only be enforceable against the parties privy to the contrast

- If a royalty is **an interest in land**, it is enforceable against the world
    - Therefore, in order to protect a royalty the royalty holder wants it to be an interest in land
    - **NOTE:** Under the LTA, you cannot have a title issued for interests smaller than 1/20th
- **Definition:** Cost free share of production. Can be used in two contexts:
    - **Lessor's Royalty:** The owner of land gets a royalty on production, which is a "cost free share of production *carved out of the mineral estate*"
        - Relatively easy to characterize a lessor's royalty as an interest in land, because it is carved out of the mineral estate.
        - IE. reserve 18% of the mineral estate that was already your 100% interest in minerals as part of your title.
    - **Gross-Overriding Royalty:** carved out of the working interest. Where a well has been farmed out, which is a "cost free share of production *carved out of the working interest*" **(i.e. it is an unencumbered right to a percentage of revenue before deductions)**
        - Example: I get my 82% interest (lessor retains 18%). I don't want to drill, so I offer a 20% GOR to another oil company to come drill.
        - Working interest is carved out from the interest of the lessee as they do not own the mineral estate, only the lease
        - More difficult to characterize a gross-overriding royalty as an interest in land. This looks more like a contract interest, rather than a property interest.
    - Ask whether the royalty is an interest in land or not? The importance of this is that an interest in land can bind future purchasers.
- **Two Approaches to Characterizing Royalties:** (courts are not settled on one in particular)
    - **Traditional approach:** Look to the wording of the instrument to see if it conveys an interest in land (***Bensette*, *Emerald*, majority in *Saskatchewan Minerals v. Keyes***)
    - **Functional approach:** Look at what the parties were attempting to achieve, and if they were ultimately successful (*Scurry Rainbow*, to some extend in *BMO v. Dynex*)

(2) ROYALTIES IN GENERAL

Bensette v. Reece (simple illustration of royalty → **[IT'S A FRACTIONAL INTEREST IN PRODUCTION; SUFFICIENT TO SUPPORT A CAVEAT AGAINST TITLE (INTEREST IN LAND]**)
Facts: Burke, a private company, owned 36 quarter sections in Sask. Two of the SH's 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." NOTE: The caveat no longer appeared on title, but purchaser of the land had notice of the caveat.
Issue: Was Bensette's royalty an interest in land or a mere contractual right?
Held: A lessor's royalty can be an interest in land. Used the words of grant, and assigned an interest in minerals of the land.
Ratio: Royalty can be an interest in land if it shows intention.
Reasons:

- **Whether something is an interest in land depends on 2 things: 1) intention, and 2) whether it can be an interest in land**
- First question is whether the grantor (Burke) even had an interest to grant (nemo dat). In this case, he did have a valid mineral estate and therefore he could transfer a fraction of his interest
- Next, we must ask whether he made a successful conveyance. Taking the precise and unambiguous words used in their ordinary and natural meaning, Burke intended to sell and transfer to Bensette a fractional 6% of its minerals in the lands
- Was the caveat valid? **Yes. An interest in minerals is a property interest, and therefore a caveat can be filed.**
- NOTE: The CA stated that granting a royalty "in" the minerals grants an interest in the land,
    - but granting a royalty "on" the minerals denotes some kind of commission, and not an interest in land.
- How did the court go about deciding whether he had an interest in land?
    - A caveat alone doesn't establish an interest in land, and so you must look to the document itself. Does the doc look like it is creating an interest in land, or does it look more like a contract (which cannot be registered)? Does it create a property interest? The words used in the document here looks like a conveyance.
    - Using the word royalty instead of interest does not change the fact that this was a conveyance.

Emerald Resources v Sterling Oil Properties [**LOOK AT THE TERMS OF THE ROYALTY AGREEMENT → DOES IT APPEAR TO DESCRIBE AN INTEREST IN LAND? IT'S 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
    - this was altered to 1%
- 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 first 6 months; this was to increase for every 6 month term of employment --? Effectively the contractor received a 6 month delay in assignment of royalty only on consummated deals
- the employee was terminated without notice, which was required

Saskatchewan Minerals v. Keyes (**[MAJORITY USED THE OLD METHOD; LASKIN'S DISSENT USHERS IN THE NEW ERA OF ROYALTY AGREEMENT INTERPRETATION → LOOK AT THE INTENTIONS OF THE PARTIES → OUGHT TO BE A REBUTTABLE PRESUMPTION THAT IT'S AN INTEREST IN LAND**)

Facts: Astral had two leases to Sask salt mines (alkali leases). Astral acquired the leases from a person who actually didn't 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." Land/leases were not covered by land titles. Sask Co buys the Astral's leases.

Issue: Was the royalty which was granted an interest in land?

Majority: Applies the traditional approach from *Bensette* and *Emerald*, which looks to the wording of the instrument to see whether it conveyed an interest in land. On this basis, it was NOT an interest in land.

- Martland: I don't care what this document grants you, you could not get an interest in these leases because you did not have the written consent of the minister.
- "on" salt & "produced & sold" once severed from the land.
- The use of the word "royalty" does not necessarily create an interest in land
    - "Royalty in MM" creates an interest in land
    - "Royalty on substances produced, saved and sold" creates a contractual interest

Dissent: Formulates a new approach, which looks at the intention of the grantor.

- Laskin says it is ridiculous to focus on tiny differences in wording: what did they mean through the word "royalty"
    - Royalty = "term of art" which can mean an intention to create a property interest.
    - Can't judge intention by tiny differences in languages.
    - 1) Look at purpose of the transaction. 2) Presumptive interest in land via "royalty"
- Let's look at the purpose of this transaction. What is a royalty? A payment made to enable someone to exploit MM. If we were talking about the surface of land, and had payment in exchange for the right to exploit resources, we would call that "rent". (ie. farmer allows you to take the crop.) Rent charge is an interest in land. Rent payment can be taken in two different ways: $x/acre or x% of money earned producing the crop of wheat from the land. In each case it is rent and has the same function that a royalty does. Therefore a royalty should be an interest in land.
- Rebuttable presumption:
    - In the absence of words to the contrary, when parties use the term "royalty" they intend to create an interest in land (*cf.* Martland)
        - So long as the words used are consistent with the granting of an interest in land, and do not negate the granting of an interest in land, then we should find that the instrument creates an interest in land (goes along with the rebuttable presumption)
            - Parties here didn't use the best words, but do indicate an intention to grant
    - If the words in the grant indicate a contractual interest, then the presumption that an interest in land was conveyed is rebutted
            - Nothing in the wording that is seen this way.
    - However, where the function of the royalty is akin to rental payments, at CL a rental charge was an interest in land and therefore, we should find this interest to be an interest in land

- Analogous to rent

(3) ROYALTY TRUST AGREEMENTS

- **Royalty Trust Agreements:** In AB, trust companies came up with an idea. They had the farmers transfer their interest to them (for a commission fee), and gave the farmers 100 trust certificate in exchange. The advantage here is that you could trade the trust certificate with neighbours and diversify your risk, and also you could subdivide your interest further than the LTA 1/20th restriction.
  - People start trading like crazy: give 5 here, 5 there. UNTIL….
  - Advantageous b/c farmers didn't know if there property would actually benefit, want to diversify.
    - NOTE: In Saskatchewan, farmers would form a freehold company w/ shares would be received based on the number of acres contributed. Production on any part of the land = a distribution profits to the SH's.
- In 1958 the AB Securities Commission prevented the trading of trust interests in OG properties without a broker by classifying them as a security
  - Trust companies lost a bunch of money because they had to keep up with certificate transfers
- **Issue:** A lessor enters into a lease with the lessees, receives a royalty interest, and then conveys that royalty interest to a trust company. The trust company gives the lessor a certificate and registers their royalty interest via caveat. A future lessee comes along and argues that the trust company has no interest in the land (only a contractual interest), and therefore the royalty interest cannot be protected by caveat.

Guaranty Trust v. Hetherington (1989) ABCA [HELD A RTA WAS A MERE CONTRACTUAL RIGHT → NOT ENFORCEABLE AGAINST SUBSEQUENT PARTIES WITHOUT THAT PRIVITY]

Facts: In 1948, Aldens leased their land to Rio Bravo. In 1952, they entered into a royalty trust agreement with Prudential Trust. 1958, Rio Bravo's lease expired without production. In 1959, Aldens sold their land to the Munroes. The Munroes subsequently passed their land to the Hetheringtons. In 1979, production occurs under the Hethington lease. A caveat is discovered which protects the RTA. OilCo argues that the royalty was conveyed away, and that only the unitholders are to be paid – not Hetherington. Hetheringtons then bring this suit saying that the RTA did not create an interest in land, and therefore, the caveat is invalid. Recognizing that there are 1000's of these RTA's in circulation, this case is essentially a test case.

Issue: Did the RTA, which requires the OilCo to pay all of the royalties to the TrustCo, create an interest in land?

Held: The major question is not answered; interest fails because the lease was not *cancelled*.

Trial: The agreement between Aldens and Rio Bravo does not create an interest in land. The court followed the traditional approach (*Bensette*, *Reese*, majority in *Keyes*). Therefore, the caveats are all invalid, and the energy companies can pay the Hetheringtons. Only transferring a share of production.

Court of Appeal:

- CA does not address the larger issue at stake (whether RTA creates an interest in land), instead deciding the case on the basis of clause 25 – the cancellation provision:
  - "The Owner hereby covenants and agrees with the Trustee that, in the event that any lease that may be in existence as at the date of this Agreement is **cancelled for any reason** or in any event that no lease is in existence as at the date of this Trust Agreement, <u>he shall and will in negotiating any lease or other instrument for developing the said lands reserve unto the Trustee the full 12.5% gross royalty</u> hereby assigned to the Trustee
  - This clause indicated that the lessor was only obligated to preserve a royalty in favour of G if the lease was cancelled yet the Rio Bravo lease had expired
  - **However, the lease was not cancelled, it expired.** The interest was only preserved if the lease was cancelled
    - DP: Think about leases. They do not have cancellation clauses. They can expire. Therefore wouldn't the parties have thought that cancelled = expire? The CA based their decision on something that could not happen.

Upshot: This result was unsatisfactory to the OG industry, therefore they begin a bunch of new test cases. Also, the bench was not composed of justices who had experience with OG issues.

- PTC 1s are the only leases with a problem: when the original lease is cancelled and the new one is entered into. These PTC 1s died with the original lease, unless the lease is "cancelled"

Scurry Rainbow v. Galloway (1993) ABQB [USED LASKIN'S APPROACH: RTA IS AN INTEREST IN LAND]
Issue: Do the RTA's create an interest in land?
Held: Yes
RATIO: Follow's the Laskin approach from *Keyes*.
REASONING:

- Follows Laskin's dissent in *Keyes*. The whole nature of this arrangement depended upon this trust agreement surviving. There was no point in entering this agreement if it only lasted as long as the lease lasted.
    - Because it is a transfer of a royalty there is a presumption that it is an interest in land, they use words that indicate that it is an interest in land, therefore it is an interest in land.
    - There is an indication that you are convenying an interest in an estate,
    - And the whole scheme was based on an interest in land.
- CA: Affirms the trial decision
- IMPORTANT TO REMEMBER THIS REASONING FLOWS FROM THE FACT THAT IT'S A PROFIT A PRENDRE
    - The lessor retains title in fee to the minerals in situ and also retains a reversionary interest → these are sufficient to support a royalty as an interest in land

Upshot: RTA's are valid in AB, therefore lessees have to pay the royalty in the RTA.

State of the Law (Pre-*BMO v. Dynex*)
Hetherington

- TJ applied Martland's traditional approach *Keyes* and said that RTAs did not create an interest in land
- CA avoided the issue ad 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 lessors held valid property interest, yet did not comment on whether the RTA effectively created an interest in land (ie. no general rule)
- **It would appear that all RTA's are valid except for the types that have a cancellation provision such as in Hetherington**
- However, there is still uncertainty in this area, so look at how the SCC addresses the issue in *Dynex*

***BMO v. Dynex* [COURT RECOGNIZED LASKIN'S APPROACH IN *KEYES*; SUBJECT TO CLEAR INTENTION OTHERWISE, IT'S AN INCORPOREAL HEREDITAMENT THAT CAN CREATE AN INTEREST IN LAND; REMITTED TO TRIAL, SO NO STRICT DICTA]**
Facts: Dynex acquired a whole bunch of OG properties in Saskatchewan, all of which were subject to various caveated interests. Many were GORRs. They went to BMO for financing, and BMO took security in the OG leases. In the 1990s, Dynex became insolvent, and BMO acquired all of Dynex's 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 interest in real property, and that they instead were only contractual interests. The GORR holders fought this assertion. Some were royalties, some were "net profit interests" – a share of profits after costs and paid.
Issue: Did the RTA create an interest in land?
Held: On these facts, the issue of determination was sent down to QB. QB said no. As for the general principle it is left undecided
Trial: The GORs 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 incorporeal hereditament)

- court, without much thought, agrees
- Some were

Appeal:

- The trial judge was wrong. Under CDN case law, it *is* possible to create a further interest in land out of an incorporeal herditament, if that is what the parties intend, so long as the interest that is created is not greater than the original interest (*nemo dat*)
- Royalties/Net Profits, all the same thing. Based on intention.
- ABCA says that Justice Laskin said that these things are interests in land. You used language indicating an interest in land, and there would be no point to create these GOR's unless they passed with the land. By filing a caveat the parties showed that they intended an interest in land. Evidence of practice, caveating, is evidence of intention
- Language of the grant & any admissible evidence of the "surrounding circumstance or behaviour, indicate that it was understood that an interest in land was created/conveyed."
    - Pushed this Laskin idea as far as it'll go.

SCC:

- Overruled a technical point of real property law that said that a GORR could never be an interest in land
- Interests in land cannot be created out of an incorporeal hereditament
    - Brief distinction is that a corporeal interest was accompanied by livery of seisen (right to immediate possession, ie. fee simple conveyance), an incorporeal interest was not (ie. OG lease)
- An OG lease is an interest in land (*Berkheiser*). Therefore 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 another interest of land out of that if you intend it.
- Quotes from ALR "royalties as used in the OG industry only make sense if they are property interests in the unproduced minerals. Owners of mineral rights should be able to create them as such if they make clear their intent to do so."
- In the last paragraph of the judgment, they state that "it appears reasonably clear that in CDN law a royalty interest or an overriding royalty interest can be an interest in land if":
    - (1) the language used in describing the interest is sufficiently precise to show that the parties intended the royalty to be a grant of an interest in land, rather than a contractual right to a portion of the OG substances recovered from the land; AND
    - (2) the interest, out of which the royalty is carved, is itself an interest in land

Remission to Trial Court: whether these *particular* documents inferred an interest in land?

- The case was referred back to trial to determine whether the royalty was an interest in land
- The trial judge looked at the language "in the event of …net substances…produced, saved and sold…", and decided that no right to take any of the petroleum substances in kind or any language which evidences an agreement to grant an interest in land
- This is exactly what Martland said in *Hambly*. This brings us right back to square one.

Summary

- This is the state of the law in Canada. We have no idea where future cases will go.
- Drafting Royalty Agreement: avoid interests in petroleum substances saved produced and sold
    - The 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
- **Bottom Line:** A royalty interest or a GORR **COULD** create an interest in land *(BMO v. Dynex)*

Chapter 6: Crown Dispositions

(1) ALBERTA PNG AGREEMENTS

A common pattern for governments of O&G producing nations is to begin with liberal royalty rates and favorable grants to oil companies to increase exploration. After production is obtained, then governments begin to increase royalties with the result that a government with a well-established basin can dictate the price of O&G royalties.

Pre-1962: P&G leases were granted for 21 years and so long thereafter as production was maintained.

- **Rationale:** Increasing exploration was the paramount goal.

1962 - 1976: P&G Leases were granted for 10 years

- **Rationale:** Government now trying to realize gains made from the previous exploration

1976: OPEC Crisis - Leases were granted for 5 years

- Retroactive change to all O&G leases, royalty rates increased

(2) 2 Tier System

A. Licence

- A license is granted for exploration. AB was divided into 3 areas.
    - **Size and duration:** Foothills (36 sections for 5 years), plains (15 sections for 2 years), northern region (32 sections for 4 years)

- **Old System:** The license holder had to explore within this period (i.e. drill a "validation well" to a specific depth) and then if oil or gas were found production was not allowed until you had applied for a lease.
    - Problem: This made the system cumbersome.
    - **Validating well:** a well drilled to a certain depth.
        - **Grouping wells:** By drilling one well you can validate your licenses on adjacent lands
        - **THIS allowed you to get the lease.**
            - Had to drill a validation well under the license to get the lease.
        - Had to drill a well w/in the spacing unit, and the lease lasted for duration of production
        - If lease is unitized, have to pay off-set payments
- Can also continue the lease if you can prove from seismic data that lease is potentially productive; BUT have to pay off-set charge

New System: Now, you can continue to produce under your license. If you drill a validating well, your license is validated. Only have to apply for an intermediate term. If you drill the well within the timeline, you request an intermediate term which grants a 5 year term (renewable)

- Advantage: Basically once you drill a validating well, and enter into the intermediate term a license is treated the same as a lease.
- **Result:** There is basically no longer any real distinction b/w license and lease

Key point: a successful well does not mean that you get to keep the whole area. Think of the land as a checkerboard; gov't wants other companies to come into and bid on the surrendered land (which now looks promising as there is production on it). Gov't gets another round of land sales revenue.

- Can't keep all the land any more once you have a validating well: Plains (keep 8 out of 15 sections), northern (11 out of 32 sections), foothills (14 out of the 36 sections). The number of sections varies by the depth of the well.
    - Cannot increase your geographical coverage by drilling more than one well.

B. Lease

- Granted to enable commercial production to happen
- **Size and Duration:** Leases have a minimum size of one section but no maximum

How do you get a lease or a license?

- **Golden Rule:** Government disposition are done by auction with very few exceptions
    - Exception: Where the crown only owns part of a DSU or a DSU includes a river or lake that is owned by the crown that is surrounded by freehold land owners the disposition is reached through negotiation.
- **Cash Bid Tender system:** There are 24 auctions per year
    - The industry selects the land, and asks that it be put up for aucton
    - *Crown Minerals Disposition Review Committee*: reviews the request (specifically for environment sensitivity), but usually approves the auction
        - Criticism: Public feedback over environmental issues is often ignored by the committee
    - 9 weeks later the land appears as a public offering and a tendering process arises (
- Auction placed on the website, and then any company can bid on the land.
    - Land owner chooses whether posted for lease or license.
    - Land, once posted, is awarded to the highest bidder
        - AB model is therefore corruption free. Other models take the bids, and then the gov't starts to ask about benefit agreements. The more details in a decision, the more room for corruption as someone has to make a decision in the end.
            - Key point: advantage of AB system is it is corruption free
    - Maximum area: see the license requirements;
    - minimum for lease = 1 section; for license in plains = 6 sections; north = 1 section

Terms of the lease (Clauses)

Granting Clause:

- HMTQ grants the lessee the right to drill and recover the leased substances if they are owned by the crown
    - Proof that the crown owns the O&G is done through the Crown Lands Registry, which operates outside the torrens system and can lead to problems

Royalty Clause: The initial bonus for the crown is the amount that you pay for the lands through the tendering process

- **Surface Fee:** A yearly surface fee is also reserved for the government (a rental rate)
- **Royalty Rate:** The amount stipulated from time to time under the MMA, or may be stipulated *from time to time* this is basically a variable rate according to current government policy
    - Simply have to change the regulations; and no one can fight it.
        - Free of any deductions, except for regulations (gas cost allowance in regs).
    - 2007: AB significantly increased their royalty rates to increase public revenue. These announcements are usually done at the peak of the market. If an oil company is invested and hears that the royalty rate is up for review it may be a good time to liquidate the investment
    - 2010/11 amendment
    - 2015/16: modernization for new activity
        - AB is getting their fair share; but we'll increase royalties for new dispositions on a go-forward basis (phased-in increase); need for stability;

2009: wanted a shallow rights reversion, legislation passed but not enforced.

- Crown has shallow rights and deep rights reversions to non-production in M&Ms
- This is fair b/c there is a compliance w/ law clause. Have to follow what the Crown says.
- Passed b/c they were concerned about sterilization of deep reserves.

Land rights

- **No warranty of title** (Champlin problem may arise) as the Crown says it grants <u>only insofar as it has the right to do so</u> (crown land registry is not under the torrens system)
    - Land Titles office doesn't cover all the province: especially in foothills & the north.
        - Also: registry assurance for mistakes in Land Title surface, but does NOT apply to M&M
        - Result? Must do historical search back to route of title.
    - Registery system under M&M Act, and anything register is prior to unregistered transfer
        - Protection ≠ guaranteed title, but constructive notice for registered lands
    - Also have to be able to register security interests.
        - See lots of bank interests as security for loans
        - Also see lots of builders lien; any unpaid contractor who worked on land can file a lien
- s.2 of Crown lease: **compliance with laws clause**: abide by all rules stipulated, both now and any new ones in the future
    - Ex. Pay the royalty rate, comply with provisions of the MMA and other legislation, nothing exempts you from the legislative rules, NG must be first used in Alberta, with permission of the government required to export it
    - Royalty rates can be changed, which is great b/c Crown can make lower or higher rates to encourage exploration

Continuation

- A lease may be continued beyond the primary term if there is a productive well (production defined by CL definition)

Lease Or License

- Today there is not a significant difference between leases and licenses, a **license will be granted for a period of 10 years**, whereas a **lease will only be given for a 5 years term**
    - Validation work under license, can have a 7, 9, or 10 yr interest; lease = 5 yr
- The only protection for licenseholders are through administrative law protections, they do not receive protection through property rights.
- **Regulation setting this out = pg 47 of statutory materials**
- The advantage of a license is time → you get a longer period from which you can enter into an intermediate term
        - **Upon validation you can enter into the intermediate term**

Reversion on continuation:

- Concern: large leased blocks of land productive below certain depths with reserves above or below being sterilized

- Solution: on continuation of lease (demonstrated capacity to produce in paying quantities), the deep rights are severed from the lease and revert to the Crown – same occurs for rights above the shallowest productive zone (within a specified period of time)
- **You can have severing of deep and shallow reserves**

Mines and Minerals Act ss 8 and 45
- s 8: Ministerial discretion exists to extend fixed term, even after expiry if it is in the public interest; ministerial discretion to reinstate a surrendered or cancelled agreement
- s 45: Minister's ability to cancel agreements

Industrial Coal
- 10 year primary term that was ongoing. Near the end, lessee takes position that an abandoned well on property is sufficient to allow for continued production.
- Trial judge said yes, because they'd be able to get production back on line pretty quickly
    - Also, government didn't act in good faith
- Court of appeal said no
    - This well was drilled way before you acquired the lease and it was never given to you as part of the lease
    - As such, you can't rely on it to say that you can maintain production

Strict interpretation of what production means and the terms of the lease

Climate Change

-
- Atmosphere is very thin → we're mostly concerned with the first three zones (50 km): troposphere, stratosphere, mesosphere
    - Major changes in atmospheric conditions = mass extinctions
- Contributors to climate change:
    - Fossil fuel combustion, deforestations and land use changes, animal husbandry, ocean destabilization, natural variation
- Consequences:
    - Desertification, altered ocean currents, altered precipitation patterns, increased incidences of extreme weather, melting ice caps, altered species habitats, famine etc
- Climate vs weather:
    - Weather is what the conditions of the atmosphere are over a short period of time
    - Climate is how the atmosphere behaves over relatively long periods of time
    - Climate change: changes in long-term averages of daily weather
    - Natural variation: 40,000-100,000 years, called Milankovich Cycles, prove to be true
- World commitments:
    - *Kyoto Protocol* → 2 commitment periods 2012: 5.2% below 1990; 2020: 18% below 1990
    - *Copenhagen Accord* → 17% below 2005 levels by 2020
    - *Paris Agreement*: holding the increase in the global average temperature to below 2C above pre-industrial levels by 2100 and pursuing a strategy to limit it to 1.5
- Under the *Copenhagen Accord*, we have committed to a reduction in 612 Mt
    - With no regulatory measures, we'd be near 860 Mt, we're currently projected to be 730 Mt; to abide with the *Paris Agreement*, we'd need to be closer to 400 Mt
- Sector by Sector Accounting of National Emissions :
    - 44% from stationary sources (electrical generation and fossil fuel mining/upgrading)
    - 27% from domestic transportation
    - 9% from fugitive gasses (venting and flaring)
    - remaining 20% from other industrial processes
- Federal Approach:

- *Canadian Environmental Protection Act* → a number of regulations under this Act seek to limit vehicle emissions and promote renewable fuels
- 2014 Greenhouse Gas Emissions Reporting Programs

- Alberta's approach:
  - *Climate Change and Emissions Management Act* (2003)
    - Specifies a target emission reduction → reduction of specified emissions relative to GDP equal to or less than 50% 1990 levels → 50% efficiency target
  - *Specified Gas Emitters Regulation*
    - Requires facilities that emit 100,000 tonnes or more of GHG to annually reduce site-specific emissions intensity by 12%
    - Allows for net increase in GHG in the short term → increased pollution so long as the increase is sufficient
    - If it works, will achieve a level 14% below 2005 levels by 2050
    - Captures 45% of provincial emissions
    - 2015 Addition:
      - reduction increases to 15% as of January 1, 2016 and 20% as of Jan 1, 2017
      - acceptable compliance:
        - can pay to pollute, invest in green tech to offset, make improvements to actually reduce, purchase credits that will be used to stimulate growth in clean sectors
  - Alberta's new approach:
    - Implement a new carbon price on GHG pollution
    - Phase out coal-generated electricity and develop more renewable energy
    - A legislated oil sands emission limit → 100Mt
      - 1/4 of Canada's carbon budget if we wish to comply with the Paris Agreement
    - methane emission reduction plan