RECENT JUDICIAL DEVELOPMENTS OF INTEREST TO OIL AND GAS LAWYERS

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This article is a compilation of recent Canadian decisions of interest to oil and gas lawyers. The authors discuss a variety of cases in areas such as lands, leases and titles, administrative law, contracts, torts, the environment and royalties.

Le présent article est une compilation des décisions canadiennes récentes destinée aux avocats oeuvrant dans les secteurs pétrolier et gazier. Les auteurs examinent divers cas dans des différents domaines — baux et titres, droit administratif, contrats, délits, environnement et redevances.

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I. INTRODUCTION

While it is difficult to point to any particular landmark decision over the last year, the courts have been very busy developing, clarifying and refining legal principles and interpreting statutory rights and obligations in the oil and gas area. For example, the courts have confirmed that:

- overriding royalties, and in some cases net profits interests, can be interests in land;

- traditional common law property principles or categories may be unsuited to the realities of the oil and gas industry;
- American case authorities must be applied cautiously due to varied approaches to basic concepts of oil and gas law that contrast with Canadian law;
- environmental scrutiny of energy projects must meet a high standard of care which requires clear statements of scope and cumulative effects, and which imposes duties on the regulator to gather information, consider, and report;
- discretionary decisions of administrative tribunals will now be reviewed by courts on a different basis;
- corporate directors may incur fiduciary duties to creditors for corporate decisions made on the eve of insolvency; and
- when corporations do seek legal protection due to their insolvency, a whole spate of legal issues will arise affecting not only creditors' rights, but also contractual rights and obligations.

In short, there have been many cases of interest to oil and gas lawyers in the last year.

II. LANDS, LEASES, AND TITLES

A. *LIEBING* V. *ALBERTA (NORTH ALBERTA LAND REGISTRATION DISTRICT)*[1]

In this case the Court of Appeal reversed the trial court decision involving the correction of a series of title mistakes made by the Registrar of Land Titles ("Registrar") dating back fifty years.

1. FACTS

The facts of this case are succinctly summarized in the Court of Appeal decision as follows:

> A municipality acquired the lands [under the *Tax Recovery Act*[2]] from Henry Liebing as a result of non-payment of taxes. The municipality sold the lands in 1944 to Roland Liebing, who in turn sold them to Earl King. Both these titles included the surface as well as the mines and minerals, although the municipality's original tax notification had stated that mines an minerals were excluded....
>
> In 1947, the Registrar purported to make certain corrections, by cancelling King's mineral title and reviving that of Henry Liebing. He also added a reservation as to mines and minerals to the cancelled title of Ronald Liebing. On Henry Liebing's death, new mineral titles (based upon the corrections that the

[1] (1999), 74 Alta. L.R. (3d) 351 (C.A.) (indexed as *King Estate* v. *Buckle Estate*) [hereinafter *Liebing*].

[2] R.S.A. 1942, c. 161.

Registrar had made to his title) were issued to his executor, Clifford Liebing. Various transfers based on those titles were made to other volunteers, including, eventually, the [Buckle estate].

It appears that, at some point, King realized that the Registrar had cancelled his mineral title. The record reveals that, in 1951, his solicitors communicated with the Registrar seeking a settlement, which was refused by the Registrar. No other action was taken by King, who died in 1972.

In 1977, the Registrar filed a caveat against the mineral title of the [Buckle estate], based on a concern that the earlier corrections had been made in error. In March 1998, by Notice of Motion, the [Buckle estate] sought to have the Registrar's caveat removed. Notice of that motion was given to the beneficiaries of King's estate, represented in these proceedings by the Appellant. In addition to seeking the removal of the Registrar's caveat, the motion also sought a declaration that the [Buckle estate], "or in the alternative, the lawful successors of Earl Grover King, Deceased" were the proper registered owners of the mines and minerals.[3]

2. DECISION OF THE COURT OF QUEEN'S BENCH[4]

Justice Rawlins allowed the Buckle estate motion and ordered the removal of the Registrar's caveat on the basis that the King estate's claim to the mineral title was barred by the ten year limitation period set out in the previous *Limitations of Actions Act*.[5] She held that the pleadings, the fact that the Buckle estate and its predecessors paid the mineral taxes, and the fact that King had requested compensation from the Registrar relating to the mineral title errors, all indicated that the King estate's claim amounted to an action for possession of land, as opposed to an action for a declaration as to title. Consequently, the King estate's claim was statute barred. Justice Rawlins distinguished *Krautt Estate* v. *Paine*[6] on the basis that the applicants in that case commenced that action challenging the Registrar's caveat within the limitation period.

3. DECISION OF THE COURT OF APPEAL

The Court of Appeal (McFadyen, Hunt, and Berger, JJ.A.) allowed an appeal by the King estate. The Court issued a declaration that the King estate is the proper registered owner of the subject mines and minerals and a direction to the Registrar to reissue titles in accordance with the appellate decision.

The Court found the *Krautt Estate* case applicable. *Krautt Estate* involved competing claims for a mineral title between a *bona fide* purchaser from a municipality (Krautt) and an owner whose title traced through a Registrar's purported correction of the municipality's error. The Court in the *Krautt Estate* case held that Krautt, as a *bona fide* purchaser for value, was entitled to rely upon the *Tax Recovery Act*, the same statute

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[3] *Liebing*, *supra* note 1 at 354.

[4] *Liebing* v. *Registrar of the North Alberta Land Registration District* (1999), 239 A.R. 183 (Q.B.). For a detailed discussion of the trial court decision, see N. Bankes & A. Quesnel, "Recent Judicial Developments of Interest to Oil and Gas Lawyers" (2000) 38 Alta. L. Rev. 294.

[5] R.S.A. 1980, c. L-15.

[6] (1980), 25 A.R. 390 (C.A.) [hereinafter *Krautt Estate*].

provisions through which the King estate derived its title. Specifically, the legislation only allowed for a challenge to a municipal sale for non-payment of taxes if the "parcel" was not actually subject to tax arrears. In the *Krautt Estate* case, because the surface rights were subject to taxes, the sale of the parcel, including mines and minerals, could not be challenged. Based on the *Krautt Estate* case, the Court held that the King estate's claim to the mines and minerals title was better than that of the Buckle estate.

The Court also found that the *Limitations of Actions Act* was not a bar to the King estate's claim for three reasons. First, while the *Krautt Estate* case does not address the limitations argument, Krautt, like King in this case, was made aware by the Registrar that his mines and mineral title was in question well before any action was commenced.[7] Second, the case at bar involved an action for a declaration of title, not an action for possession of land, as evidenced by the pleadings. Following Justice Rand's *dicta* in *C.P.R.* v. *Turta*,[8] as adopted by the Court of Appeal in *Kaup* v. *Imperial Oil Ltd.*,[9] an action for declaration does not raise the issue of limitation periods.[10] Third, following the Court of Appeal's decision in *Duncan* v. *Joslin*,[11] which apparently was not before the trial court, adverse possession of a mineral estate is not established by payment of mineral taxes.[12]

Based on previous authority, the outcome of this decision is not surprising. In last year's article Professor Bankes noted that Justice Rawlins' decision was probably inconsistent with that previous authority. Professor Bankes' conclusions have been borne out by the Court of Appeal.

B. *WHARTON* V. *SMERYCHYNSKI*[13]

This case deals with an action for rescission, or alternatively, rectification of an agreement for the sale of land where the vendor mistakenly failed to exclude an acreage from the titled quarter section sold.

1. FACTS

The relevant facts are as follows:

> In May 1996, Peter Smerychynski bought a quarter section of land from the Whartons. Both Mr. Smerychynski and the Whartons employed lawyers who prepared and reviewed the documents that contained the offer to purchase the land and the eventual transfer of the property. When he entered into the agreement, Mr. Smerychynski knew that the Whartons had, during the preceding fall and winter, posted a large "For Sale" sign on the building site portion of the quarter and had done some work on the building site. When Mr. Smerychynski's lawyers searched the title to the property prior to making the

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7 *Liebing, supra* note 1 at 357.
8 [1954] S.C.R. 427 at 456-57.
9 [1962] S.C.R. 170 at 194.
10 *Liebing, supra* note 1 at 358.
11 (1965), 51 W.W.R. 346 (Alta. S.C. (A.D.)).
12 *Liebing, supra* note 1 at 358.
13 [2000] 5 W.W.R. 605 (Alta. Q.B.) [hereinafter *Wharton*].

offer to buy the land, they found a Caveat, registered in September 1995 by the County of Barrhead ["County"], for a road widening obtained by the county as a "condition of subdivision." However, the title showed that no subdivision had ever been registered. When Mr. Smerychynski obtained an appraisal of the quarter for his bankers as a prerequisite to loaning him money to buy the property, the appraisal included the following comment: "An acreage of a little over 3 acres has been subdivided in the extreme southeast corner. It does not go with the property."[14]

2. DECISION

The Whartons' case relied on an argument of mistake. Justice Veit noted that in order for the Whartons to succeed on that basis, thus leading to rescission, they would have to establish that there was a mistake about a material term, which Smerychynski constructively or actually knew about, and that it would be unconscionable if the agreement were enforced. She held that

> although there was a mistake by the Whartons, and the mistake related to a material term of the agreement to sell land, the mistake by the Whartons was not obvious to a reasonable person in the light of all the circumstances.... Smerychynski had no knowledge of the mistake. There would be no unconscionable result if the agreement were enforced.[15]

Justice Veit also addressed ss. 64 and 195 of the *Land Titles Act*[16] as those sections related to Smerychynski's case. She held that Smerychynski was entitled to rely on the "mirror" principle (*i.e.*, a Torrens certificate of land title accurately reflects all interests relating to the titled property) codified in s. 64[17] insofar as he was not an immediate party to the Whartons' subdivision arrangement.[18] Smerychynski was also entitled to rely on s. 195[19] which sets out the "curtain" principle (*i.e.*, a purchaser can rely on the

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[14] *Ibid.* at 606-608.

[15] *Ibid.* at 619.

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

[17] Section 64(1) reads:

> *The owner of land in whose name a certificate of title has been granted* shall, except in case of fraud wherein he has participated or colluded, *hold it*, subject (in addition to the incidents implied by virtue of this Act) to the encumbrances, liens, estates and interests that are endorsed on the certificate of title, *absolutely free from all other encumbrances, liens, estates or interests whatsoever* except the estate or interest of an owner claiming the same land under a prior certificate of title granted under this Act or granted under any law heretofore in force and relating to title to real property [emphasis added].

[18] *Wharton*, *supra* note 13 at 620.

[19] Section 195(2) reads:

> A *person contracting or dealing with or taking or proposing to take a transfer*, mortgage, encumbrance, lease or other interest *from an owner is not*, except in the case of fraud by that person,
>
> (a) *bound or concerned*, for the purpose of obtaining priority over a trust or other interest that is not registered by instrument or caveat, *to inquire into or ascertain the circumstances in or the consideration for which the owner or any previous owner of the interest acquired the interest* or to see to the application of the purchase money or any part of the money, or

register to determine all existing interests in land). The County's caveat only protected its interest in the event that the Whartons' subdivision was registered. The County's caveat did not protect any interest which the Whartons' might have in the property. In any event, no subdivision was registered at the time of sale.[20] Justice Veit also confirmed the Court's jurisdiction pursuant to ss. 180 and 199 of the *Land Titles Act* to correct by order of the court, a Torrens land title resulting from the title holder's unilateral mistake, although she did not have to exercise such jurisdiction in this case.[21] In the result, the Whartons' action was dismissed.

C. *AEC OIL AND GAS CO. V. ALBERTA (MINISTER OF ENVIRONMENT PROTECTION)*[22]

This surface rights case addresses whether there is a difference between a "grazing lease" and a "forest grazing licence," both issued under the *Public Lands Act*,[23] and related to entitlement to compensation ordered by the Surface Rights Board ("SRB"). In doing so, the Alberta Court of Queen's Bench reiterated that traditional common law property principles or categories may be unsuited to the realities of the oil and gas industry.

1. FACTS

Evans held a forest grazing licence on lands to which AEC Oil & Gas Co. ("AEC") held an SRB right of entry order for a well site. In a split decision of the SRB, Evans was found to be entitled to compensation under the *Surface Rights Act*.[24] The majority decided that Evans, as the holder of the forest grazing licence, should be treated the same as a grazing lessee and consequently an "occupant" under the *SRA*. AEC appealed to the Court of Queen's Bench.

2. DECISION

The issue on appeal was whether Evans, as the holder of a forest grazing licence, constituted an "occupant" under s. 1(g)(iv) of the *SRA*. That section defines "occupant" as, "in the case of Crown land, a person shown on the records of the department or other body administering the land as having an interest in the land."

Justice Wilkins began his analysis by noting the various circumstances in which AEC had treated Evans as an occupant. He found that while the AEC was not estopped from

(b) affected by any notice, direct, implied or constructive, of any trust or other interest in the land that is not registered by instrument or caveat, any rule of law or equity to the contrary notwithstanding [emphasis added].

20 *Wharton*, *supra* note 13 at 621.

21 *Ibid.* at 622.

22 [2000] A.J. No. 353 (Q.B.), online: QL (AJ) [hereinafter *AEC*].

23 R.S.A. 1980, c. P-30.

24 R.S.A. 1980, c. S-27.1 [hereinafter the *SRA*].

arguing that Evans was not an occupant for compensation purposes, it bore a "heavy onus" to show that Evans fell outside of the scope of the definition.[25]

AEC advanced two arguments why Evans did not constitute an occupant and hence was not entitled to compensation. First, it submitted that s. 23(1) of the *Forest Grazing Licence Regulations*[26] precluded a forest grazing licence holder from claiming compensation from the minister or a third party in circumstances where the minister authorized the third party to enter upon the same lands as the forest grazing licence. Justice Wilkins dismissed this argument by noting that AEC's entry was under a right of entry order, not a ministerial authorization.[27] In fact, the minister's consent to the SRB issuing AEC's right of entry order was expressly conditioned on AEC obtaining the consent of Evans. Further, the *SRA* is a "legislative scheme created to determine any issues where the consent of holders of prior rights cannot be obtained."[28]

AEC's second argument was to distinguish between the property rights inherent in a lease and those in a licence. AEC based its argument on common law which has relied on this distinction for centuries. Justice Wilkins dismissed this argument by first cautioning against blindly applying to the oil and gas industry legal doctrine from other areas of law or foreign jurisdictions.[29] This caution has been given in a number of recent cases.[30] "The [SRB] is entitled to look at the practical effect upon a holder of a grazing licence or lease and give consideration to similarities on the operations which flow from each type of contract [*i.e.*, lease or licence]."[31] Justice Wilkins went on to note that the *SRA* did not expressly distinguish between a lease and a licence. He cited s. 1(o) of the *SRA*, which defines "surface lease" to mean "a lease or other instrument under which the surface of land is being held for any purpose for which a right of entry order may be made under this act and that provides for payment of compensation," which he concluded was broad enough to encompass any grazing licence.[32] We note, however, that the definition of a "surface lease" in the *SRA* refers only to the interest obtained by an operator, such as AEC, and not the nature of the occupant's (Evans) interest.[33] In our view, Justice Wilkins' more persuasive reasoning comes later where he finds that "the

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25 *AEC*, *supra* note 22 at para. 47.

26 Alta. Reg. 309/71; since repealed and superceded by *Dispositions and Fees Regulation*, Alta. Reg. 54/2000, s. 44(1). Section 23 read:

> 23(1) If the Minister authorizes a third party to enter onto and make a different use of public land on which a forest grazing licence is in effect, the licencee may not claim compensation from the Minister or from the third party for either (a) the entry onto or use of the land, or (b) loss of grazing capacity due to the entry onto or use of the land.

27 *AEC*, *supra* note 22 at paras. 49 and 51.

28 *Ibid.* at para. 50.

29 *Ibid.* at para. 52.

30 See the *Dynex* and *Scurry-Rainbow* cases, *infra* notes 36 and 39.

31 *AEC*, *supra* note 22 at para. 53.

32 *Ibid.* at paras. 54-55.

33 *SRA*, *supra* note 24, s. 19 (entry fee), s. 27 (review of rate of compensation), s. 39 (compensation) and s. 44 (regulations).

terms of s. 8(1)[34] of the [Forest Grazing Licence] Regulations cannot preclude the finding of this Court that Evans, as licencee is shown as a person on the records of the Department as having an interest in land and therefore an occupant as defined by the Act."[35] In so finding, Justice Wilkins apparently construed the phrase "an interest in the land" as it is used in the *SRA* definition of "occupant" as broader than the common law definition, thus including a Crown-granted licence. In the result, the Court confirmed the SRB's majority decision.

The *AEC* case stands for the proposition that right of entry and compensation pursuant to the *SRA* is not dependant upon whether the occupant owns a common law interest in land, at least insofar as Crown-granted licences are concerned. Rather, provided that an occupant can establish an "interest in land" at common law or pursuant to a *Public Lands Act* disposition, and establishes that this will be adversely affected by the operator's activity, the occupant is then entitled to compensation in relation to that interest.

III. ROYALTIES

A. *BANK OF MONTREAL V. DYNEX PETROLEUM LTD.*[36]

This recent decision of the Alberta Court of Appeal clarifies that a gross overriding royalty or, in some cases, a net profit interest, can constitute an interest in land. The appeal concerned three applications heard by Justice Rooke between 1995 and 1997. In arriving at its decision, the Court of Appeal did not have to address the trial court's findings relating to the priority of bank debenture security versus the overriding royalty or net profit interests and whether an intervening bankruptcy affected that priority.

1. FACTS

Dynex Petroleum Ltd. ("Dynex") was petitioned into bankruptcy by its debenture holder, the Bank of Montreal ("Bank"). The trustee of Dynex's estate wanted to sell Dynex's petroleum and natural gas ("PNG") interests. Certain PNG interests were subject to overriding royalties and net profit interests (collectively "ORRs") in favour of Enchant Resources Ltd. and D.S. Willness. The issue that arose was whether the Dynex's PNG interests must be sold subject the ORRs.

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34 Section 8(1) reads:

> A grazing licence gives the licencee the exclusive right to pasture livestock on the land that is the subject of the licence but does not convey any general interest in the land.

35 *AEC*, *supra* note 22 at para. 60.

36 (1999), 74 Alta. L.R. (3d) 219 (C.A.) [hereinafter *Dynex*].

2. DECISION OF THE COURT OF QUEEN'S BENCH[37]

Justice Rooke, in his reasons dated December 19, 1995, held that overriding royalties do not constitute an interest in land. He held that the interests of the ORRs constituted a chose in action, basically, an unsecured claim which could only be a secured interest in personalty if the ORRs had registered pursuant to the *Personal Property Security Act*:

> As a matter of law, he found that a lessee of an oil and gas lease (which is a *profit à prendre*), which is in itself an interest in land, obtained from a lessor (whether the Crown or freehold), cannot pass an interest in land to a third party.... [I]f it were possible to have an interest in land, it required an examination of the language of the instrument to see if the intention of the parties was to create such an interest.[38]

Justice Rooke determined that, on the issue of priorities, the Bank had subordinated its interest to the ORRs prior to Dynex's bankruptcy and the subordination survived the bankruptcy.

3. DECISION OF THE ALBERTA COURT OF APPEAL

The Court (Foisy, Berger, and Sulatycky JJ.A.) held that ORRs can indeed constitute an interest in land. The Court's analysis contains a detailed summary of Canadian and American jurisprudence, as well as academic commentaries which consider the nature of various types of royalties.

Of specific note are the following points:

- The Court adopted Justice Hunt's (as she then was) cautions and observations in *Scurry-Rainbow Oil Ltd.* v. *Galloway Estate*[39] that (i) American authorities must be used cautiously because different American jurisdictions have adopted varied approaches to basic concepts of oil and gas law that may be in distinct contrast to Canadian law, (ii) too rigid reliance on common law principles developed in vastly different circumstances may lead to results inconsistent with the realities of the industry, and (iii) documents must be interpreted in their context.[40]

- The Court defined royalties, overriding royalties, and net profit interests as follows:

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37 *Bank of Montreal* v. *Dynex Petroleum Ltd.* (1995), 39 Alta. L.R. (3d) 66 (Q.B.); (1997), 50 Alta. L.R. (3d) 44 (Q.B.). Involved applications by the parties in Chambers seeking summary judgment to determine priorities. For a detailed discussion of these applications see G.D. Baker & C.A. Crang, "Recent Judicial Developments of Interest to Oil and Gas Lawyers" (1999) 37 Alta. L. Rev. 439 at 456.

38 *Dynex*, *supra* note 36 at 226.

39 (1993), 8 Alta. L.R. (3d) 225 (Q.B.), aff'd (1994), 23 Alta. L.R. (3d) 193 (C.A.); leave to appeal denied (1995), 26 Alta. L.R. (3d) 1 (S.C.C.) [hereinafter *Scurry-Rainbow*].

40 *Dynex*, *supra* note 36 at 227-28.

> A lessor's royalty is a share of the product or the proceeds reserved to the owner for permitting another to use the property and also a right to receive, either in kind or its equivalent in money, a stipulated fraction of the oil and gas produced and saved from the property covered by the lease, free of all costs of development and production.
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> An overriding royalty or gross overriding royalty is an unencumbered share or fractional interest in the gross production granted to a third party in exchange for performing duties (*e.g.* drilling). Commonly. it is reserved in an assignment, part assignment or sublease of an oil and gas lease, often carved out or reserved by lessees who have a working interest created by a lease.
>
> A net profits interest includes, at least, the right to receive a portion of the proceeds from the sale of petroleum and natural gas....
>
> [I]n each particular case, the interest conveyed is to be found by interpreting the agreement as a whole and within its context. A net profits interest, in many cases, can function in much the same manner as a royalty or other non-working interests where the interest is a right to a share of production as opposed to a right to a certain amount of money out of a certain described portion of production.[41]

While addressing royalties and overriding royalties, the Court makes it clear that where the intention of the parties to a net profits agreement was to create an interest in land, the result should be the same.

- The Court adopted Justice Hunt's decision in *Scurry-Rainbow*, finding that a lessor's royalty could constitute an interest in land in the form of a "species of rent" or akin to rent or a *profit à prendre*. Further, such an interest is assignable to a third party.[42]
- The Court found that

> [f]or all intents and purposes, an overriding royalty is the same as a royalty; both are an unencumbered share of production. To distinguish between these two forms of royalty is to place form before substance. Royalties, whatever their origin, should be subject to the same set of rules.[43]

- Justice Rooke previously had held that he was bound by authorities which state that an interest in land cannot be passed to a third party from a lessee of an oil and gas lease. The Court of Appeal summarized this argument by stating that "[a] lessee only possesses a profit à prendre. A profit à prendre is an incorporeal hereditament. An interest in land can only be created from the corporeal estate."[44] However, the Court of Appeal held that "royalties and ORRs need not be classified into a traditional common law property category unsuited to the

41 *Dynex* at 228-29 [footnotes omitted].
42 *Dynex* at 232.
43 *Ibid.*
44 *Dynex* 232-33.

realities of the oil and gas industry and need not be subject to the arcane strictures of traditional categories."[45] Traditional categorizations, such as the dichotomy between corporeal and incorporeal rights do not fit the industry and should not be a bar to finding that an ORR can constitute an interest in land.[46]

- The Court found that whether a particular interest is an interest in land will depend upon the intention of the parties. In this regard, the Court approved the approach taken by Justice Hunt in the *Scurry-Rainbow* case, and by Justice Matheson in *Canco Oil & Gas Ltd.* v. *Saskatchewan*[47] to "examine the parties' intentions from the agreement as a whole, along with the surrounding circumstances, as opposed to searching for some magic words."[48]

- The Court recognized that while American jurisprudence on this point is somewhat inconsistent from state to state, the majority of the jurisdictions have found that an ORR can be an interest in land.[49]

In concluding that an ORR can constitute an interest in land, the Court provided the following non-exhaustive list of indicia to examine in determining whether the parties intended that result:

1. The underlying interest is an interest in land (corporeal or incorporeal);
2. The intentions of the parties, as evidenced by the language of the grant and any admissible evidence of the surrounding circumstances or behaviour, indicate that it was understood that an interest in land was created/conveyed;
3. The interest is capable of lasting for the duration of the underlying estate.[50]

Other possible indicia include the wording in the ORR clause which create:

1. A reservation of interest in the petroleum substances by the farmor in the working interest to be earned by the farmee.
2. The farmee as agent of the farmor for the farmor's share of petroleum production.
3. Remedies against the interest of the farmee through a lien.[51]

In the result, the Court found that findings of fact were required to determine whether the ORRs in this case were interests in land and referred the matter back for trial. On February 15, 2000 the Bank applied for leave to appeal to the Supreme Court of Canada.[52] As of August 15, 2000, no decision has had been issued on the Bank's leave application.

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45 *Dynex* at 233.
46 *Dynex* at 235-36.
47 (1991), 89 Sask. R. 37 (Q.B.).
48 *Dynex, supra* note 36 at 237.
49 *Ibid.* at 238.
50 *Ibid.* at 239.
51 *Ibid.* at 239-40.
52 [2000] S.C.C.A. No. 152, online: QL (SCCA).

This is an important decision because Alberta's highest court has held that, despite common law principles relating to other types of real property, royalties, overriding royalties, and, in certain cases, net profit, interests can be interests in land if the manifest intention is present.

B. *MONTREAL TRUST CO. OF CANADA* V. *ASTL*[53]

This case follows a series of decisions dealing with gross royalty trust agreements ("GRTs"). It provides a useful recap for oil and gas lawyers of the present status of the law relating to GRTs. The basic issue in prior cases was whether GRTs required subsequent mineral owners to pay royalties to GRT unit holders. The issue in this case was whether mineral owners could rely upon the prior GRT cases to conclude that certain GRTs, in a form used by Prudential Trust Company Limited ("PTC-1"), had terminated thereby dictating the payment of monies in court to the mineral owners, or whether the mineral owners had to comply with the "collapse process" established in prior litigation.

1. BACKGROUND

The history of GRTs date back some fifty years. Justice Mason provides the following summary:

> In 1949, the *Land Titles Act*, S.A. 1942 c. 205 was amended (SA 1949 c. 56) by the addition of the following new section immediately after Section 52:
>
> ...
>
>> 52(a) The Registrar may refuse to accept for registration any instrument transferring, encumbering or otherwise disposing of an undivided fractional interest in a parcel of land containing mines and minerals, or any mineral, which is less than undivided 1/20th of the whole interest in mines or minerals, or in any mineral, contained in that parcel of land.[54]
>
> Often the mineral owner would first enter into a petroleum and natural gas lease with an oil company. Typically the lease granted the oil company the right to win oil and natural gas from the lands, in return for which the oil company would pay to the mineral titleholder a royalty, usually 12 ½ percent of the value of the production of the oil and gas obtained pursuant to the terms of the lease. Then the mineral owner would establish a GRT under which the lessee oil companies paid the royalties due to the mineral owner to a trust company to hold in trust pursuant to the terms of the GRT. The trustees received the royalties at the behest of the mineral owner who, as the settlor of the trust, required the trust company to issue unit certificates of ownership in the royalty funds paid to it. Unit certificates issued by the trust companies pursuant to GRTs were traded by way of sale or exchange in street form through endorsement of the transfer on the reverse side of the certificate. This permitted the gift, sale, trade or transfer of the units by certificate which entitled the unit holders to share, according to their prorated number of units, in the royalties payable under the petroleum and natural gas lease.

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[53] (2000), 74 Alta. L.R. (3d) 385 (Q.B.) [hereinafter *Astl*].

[54] See *Land Titles Act*, R.S.A. 1980, c. L-5, s. 55.

> Freehold minerals owners generally set up GRTs to facilitate the distribution of oil and gas royalties to other persons by way of either sale, trade or gift. The GRTs enabled mineral owners to obtain an immediate cash payment through sale of all or some of their GRT certificates. By trading GRT certificates with their neighbours or others, mineral owners could potentially increase the opportunity of participating in successful oil and gas wells.
>
> The trust company typically filed a caveat against the mineral title to warn lessees and future owners of the mineral title that the royalty payable under the petroleum and natural gas lease was payable to the trust company in accordance with the terms of the GRT.[55]

The nature of GRTs was called into question with the Alberta Court of Queen's Bench and Court of Appeal decisions in *Guaranty Trust Co.* v. *Hetherington.*[56] At trial, Justice O'Leary (as he was then) held that the property interest transferred from the mineral owner to the trust company was not an interest in land and thus the caveat that had been registered against title had to be removed. A new mineral owner was not a party to the original trust agreement and was not bound to honour it.[57]

The *Hetherington* trial decision was appealed with the result described by Justice Mason as follows:

> Due to specific wording of the trust agreements in the *Hetherington* and *Damkar* cases, each royalty trust terminated upon the expiry of the lease that was in existence at the time the trust agreements were executed. As production of oil and gas in both the *Hetherington* and *Damkar* cases was under "subsequent" leases, the oil and gas royalties were to be paid to the mineral title owners, rather than to the trust company for disbursement to the unit holders. The question of whether or not the agreements granted an interest in land was not addressed by the Court of Appeal. The *Hetherington* case stands for the proposition that where the original petroleum and natural gas lease, referred to in a commonly used form of GRT ("PTC-1") expired according to its own terms, the PTC-1 form of GRT likewise expired and did not catch or bind subsequent petroleum and natural gas leases of the same mineral rights.[58]

Subsequent to the Court of Appeal's decision in *Hetherington*, a number of other actions were commenced which contested the validity of other GRTs. At one stage, $14 million was held by the court pursuant to interpleader orders pending resolution of those actions. A "collapse procedure" was developed as described as follows by Justice Mason:

> [W]ith the aid of counsel ... a process was developed that permitted the collapse or termination of trusts that fitted into the category of the PTC-1 GRT, in which the original oil and gas lease had terminated through the effluxion of time and the royalties were being paid under a subsequent lease. In cases such as this, a number of the mineral titleholders applied to terminate the GRTs. This was done by agreement between the mineral title holders and the unit holders, or by way of termination proceedings. On the appropriate evidence being presented to this Court to bring a subsequent lease PTC-1 GRT within the

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[55] *Astl*, *supra* note 53 at 387-88.

[56] (1987), 50 Alta. L.R. (2d) 193 (Q.B.); (1989), 67 Alta. L.R. (2d) 290 (C.A.); leave to appeal denied (1989), 70 Alta. L.R. (2d) liii (S.C.C.) [hereinafter *Hetherington*].

[57] *Astl*, *supra* note 53 at 388.

[58] *Ibid.* at 389.

> ambit of the *Hetherington* decision, a collapse Order would issue but that Order would only become effective 45 days after the GRT unit holders had all been personally served with the collapse Order and provided no action had been started in the meantime to uphold the GRT. The process was designed to bring notice of the application to collapse to all of the unit holders to give them the opportunity to intervene and take issue with the evidence on which the application for termination was made.[59]

Three test cases were also established by court order which considered whether the various forms of GRTs (i) constituted an interest in land, (ii) applied to royalties pursuant to a lease subsequent to the lease upon which a GRT was originally based, and (iii) offended the rule against perpetuities. Those cases were heard together by Justice Hunt (as she then was) and are reported as the *Scurry-Rainbow* case. Justice Hunt found in favour of the GRTs' unit holders in all three cases. Specifically, in dealing with a PTC-1 form of GRT she found that it was an interest in land acquired by the trustee sufficient to be protected by way of caveat at the Land Titles Office, and enforceable against subsequent mineral owners. Further, a PTC-1 form of GRT does not offend the rule against perpetuities.

Subsequent to *Hetherington* and *Scurry-Rainbow*, most, but not all, of the money that had been interplead into court was paid out in accordance with the collapse procedure. The *Astl* case deals with the remaining funds paid into court.

2. FACTS

As noted above, the type of GRTs at issue in the *Astl* case are the PTC-1 form overlaying a subsequent mineral lease, which was considered in both *Hetherington* and *Scurry-Rainbow.*

3. DECISION

In *Astl* the mineral owners argued that pursuant to *Hetherington*, the subject GRTs are *prima facie* defunct because the original lease in all cases has expired "through effluxion of the primary term of the lease."[60] They took the position that the interplead funds should be paid directly to the appropriate mineral owners or their nominees, subject to notification to the unit holders.

The unit holders disputed this position and argued that the collapse procedure must be followed as it afforded any party with an interest the opportunity to dispute any proposed disposition of the interplead funds.[61] The unit holders emphasised the following quote from the Court of Appeal's decision in *Barrett* v. *Krebs*:[62]

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59 *Ibid.* at 390-91.

60 *Ibid.* at 394.

61 *Ibid.* at 397.

62 (1995), 27 Alta. L.R. (3d) 27 (QB.), aff'd (1995), 32 Alta. L.R. (3d) 224 (C.A.); (1996), 37 Alta. L.R. (3d) 274 (C.A.).

> [A] finding like that in *Hetherington* is, at bottom, a finding of fact about the true intent of the parties. While I accept that it has, in these special circumstances, substantial precedential force, it, like all findings of fact, can be distinguished by a trial judge who hears new evidence of a commanding nature to the opposite effect.[63]

The unit holders argued that "the mere classification of a GRT as a PTC-1 subsequent lease, without more, does not provide sufficient evidence that it fits into the precedential form dealt with by the Court of Appeal in *Hetherington*."[64]

Mr. Justice Mason held as follows:

> Given the history and context of this matter, the fatal flaw in the mineral owners' position is that they seek the results of a termination order without complying with the process developed during the period of dealing with the interplead funds.... An integral part of this process is evidence.
>
> The suggested method of dealing with interplead funds based only on the classification of those trusts by the trust company, without sworn evidence before the Court is inappropriate. Such a blanket determination could effectively terminate GRTs in the absence of evidence that neither side wishes to terminate.
>
> I direct that the interplead funds be paid out of Court to Montreal Trust for distribution to the appropriate unit holders and that payments under the GRTs in question be resumed to those unit holders, with no payments to be made until 90 days after service of this Order and reason on all necessary mineral title owners. Mineral title owners will not have recourse to Montreal Trust, its predecessors or unit holders for monies paid out pursuant to this Order, nor will they have recourse for past royalties distributed under the terms of the GRTs.[65]

As discussed above, this case summarizes the law arising out of the lengthy dispute relating to the nature of GRTs and appears to signal the end of that saga.

IV. CONTRACTS/INDUSTRY AGREEMENTS

A. *RE BLUE RANGE RESOURCE CORP.*[66] — DEDICATED GAS SUPPLY AGREEMENTS

A number of cases dealing with Blue Range Resource Corp. ("Blue Range") are discussed in the sections of this article dealing with "Creditors' Rights and Trusts." One aspect of the following Blue Range decision provides guidance as to whether a dedicated gas supply agreement can constitute an interest in land thereby forming an encumbrance binding a purchaser of the corresponding natural gas leases.

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[63] (1995), 32 Alta. L.R. (3d) 224 (C.A.) at 232.

[64] *Astl, supra* note 53 at 399.

[65] *Ibid.* at 400.

[66] (1999), 245 A.R. 154 (Q.B.), rev'd on other grounds [2000] A.J. No. 830 (C.A.), online: QL (AJ) [hereinafter *Blue Range* — Dedicated Gas Supply Agreements].

1. FACTS

Blue Range held certain natural gas leases and was a party to a number of long-term gas supply agreements with various gas marketing companies, including Engage Energy Canada, L.P. ("Engage"), Duke Energy Marketing Limited Partnership ("Duke"), and CanWest Gas Supply Inc. ("CanWest").

On March 2, 1999, Blue Range commenced proceedings under the *Companies' Creditors Arrangement Act*[67] and obtained an order staying proceedings and claims against it, including creditors' actions. That order, however, did not relate to "eligible financial contracts" as defined in s. 11.1(1) of the *CCAA*. The *CCAA* order also allowed Blue Range to terminate any of its arrangements, including marketing agreements, as it deemed appropriate, and to make provisions for the consequences of such termination in the plan of arrangement.

As part of its restructuring, Blue Range intended to sell certain natural gas leases which supported its long-term gas supply agreements with Engage, Duke, and CanWest (the "Supply Agreements"). Because the Supply Agreements provided for a lower gas price than current spot prices, Blue Range terminated the Supply Agreements in order to attribute a higher value to the leases. That termination took place on March 31, 1999, after Blue Range had supplied Engage, Duke, and CanWest with gas for February and March under the Supply Agreements. While the wording of each of the Supply Agreements was different, the monthly payment under each of the them was due on the twenty-fifth day of the following month. At the time of the hearing, Duke and Engage had not paid Blue Range for gas supplied in February or March. However, Duke had paid the monitor the amount owing for February reserving its right to argue set-off.

Engage and CanWest applied for a declaration that if any of the leases which were dedicated to their respective Supply Agreements were sold, the termination of those Supply Agreements would be ineffective and the subject leases would remain encumbered by the Supply Agreements. They also applied for two other grounds of relief (set-off and eligible financial contracts) which are discussed in the sections of this article dealing with "Creditors' Rights."

2. DECISION

The reserve dedication provision in each of the Supply Agreements is worded slightly differently. For example:

> Seller herein agrees to dedicate Seller's share of the Remaining Recoverable Reserves to Buyer and Buyer herein agrees to accept such reserve dedication from Seller.
>
> ...

[67] R.S.C. 1985, c. C-36 [hereinafter *CCAA*].

3. The Assignee [Blue Range] covenants and agrees with CanWest that it now owns and possess a right, title, interest and estate in the lands and leases formerly owned by the Assignor and dedicated to the Contract(s) as set out in the attached Schedule "A."

...

Seller shall dedicate sufficient lands and gas reserves in the Silver area attached hereto as Schedule "A".[68]

After considering the ordinary meaning of the word "dedicate," Justice LoVecchio held that:

[t]his word does not connote a transfer or assignment of an interest.... In my view, the word "dedicate" alone, without more, should not be seen as creating anything other than a contractual covenant in favour of the other party to the contract.

This word connotes to me only an intention by Blue Range to give an assurance of its ability to perform.[69]

He went on to note that there was no binding authority which would preclude the creation of such an interest in land if the parties so intended. Reference was made to *Scurry-Rainbow* as authority for the analogous proposition that certain royalty interests could amount to an interest in land.[70]

Reference was also made to the trial court decision in *Bank of Montreal* v. *Dynex Petroleum Ltd.*[71] as authority for the proposition that an interest in land cannot be created out of an oil and gas lease. However, given his finding that the specific words in the Supply Agreements were insufficient to create an interest in land, Justice LoVecchio did not address whether that case applied. In any event, that case has been subsequently overturned as discussed above in the section of this article on "Royalties."

In the result, the "dedication" provisions in the Supply Agreements were held not to create an interest in land, thus they did not encumber the sale of the Blue Range natural gas leases.

B. *TAYLOR* V. *LOCHIEL EXPLORATION LTD. (RECEIVER AND MANAGER OF)*[72]

This case examines a dispute involving the failure to attach a land schedule to a purchase and sale agreement and the resulting failure to transfer certain lands.

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68 *Blue Range* — Dedicated Gas Supply Agreements, *supra* note 66 at 159.

69 *Ibid.* at 160.

70 *Ibid.*

71 (1995), 39 Alta. L.R. (3d) 66 (Q.B.); overturned by the *Dynex* case, *supra* note 36.

72 [1998] A.J. No. 1391, online: QL (AJ) [hereinafter *Taylor*].

1. FACTS

The receiver of Lochiel Exploration Ltd. ("Lochiel") entered into negotiations with Taylor in order to settle two lawsuits commenced by Taylor against Lochiel in exchange for cash and a transfer of certain oil and gas properties. By way of a letter dated January 30, 1990 (the "January 30th Letter"), the receiver advised Taylor that it was prepared to transfer the Lochiel properties which remained in its possession. The January 30th Letter attached a list of lands which did not include certain lands known as the Banquereau lands. These lands had proven gas reserves located undersea on the Scotian Shelf. On February 12, 1990, Taylor wrote to the receiver advising that he was prepared to discontinue his lawsuits in exchange for transfer of the lands listed in the January 30th Letter and other consideration. Taylor's evidence at trial was that he believed the Banquereau lands were included in the list attached to the January 30th Letter and in any event was to receive all Lochiel properties not otherwise disposed of by the receiver before February, 1990. The receiver's evidence contradicted Taylor's evidence on this point.

On May 9, 1990 the receiver forwarded a list of assets to Taylor at his request. That list did not include the Banquereau lands. Taylor reviewed that list and faxed it back with several handwritten additions, including the Banquereau lands. The receiver and Taylor's legal counsel had follow-up discussions on June 7, 1990 regarding Taylor's handwritten additions. The uncontested evidence of Taylor's counsel was that the receiver advised that Taylor could have all of the properties which he had written in by hand (including the Banquereau lands) with the exception of one Arctic property. Presumably, based on those discussions, the receiver prepared a list dated June 8, 1990, which included the Banquereau lands (the "June 8th List") and faxed it to Taylor. The June 8th List was entitled "Attached to and forming part of a Agreement of Purchase and Sale dated ________, 1990 between Collins Barrow Limited, Liquidator for Lochiel Exploration Ltd. and Nicholas William Taylor."

The receiver and Taylor subsequently executed a Settlement Agreement dated June 18, 1990 ("Settlement Agreement") whereby Taylor agreed to discontinue his lawsuits and the receiver agreed to pay Taylor a sum of money and to transfer the assets identified in the attached Schedule "A." However, the Settlement Agreement was executed without any Schedule "A" being attached. The receiver subsequently received court approval of the Settlement Agreement on the mistaken representation to the court that a Schedule "A" did indeed exist.

Taylor's evidence was that the June 8th List was intended to be Schedule "A" to the Settlement Agreement and he executed the Settlement Agreement on that basis. On the receiver's part, there was some confusion as to why the Banquereau lands were on the June 8th List. The receiver's senior personnel testified that he did not recall seeing the June 8th List prior to signing the Settlement Agreement. His understanding was that the Settlement Agreement was signed without Schedule "A" because no Schedule "A" had been agreed upon at the time of execution.

After execution and court approval of the Settlement Agreement, a dispute arose between Taylor and Lochiel as to whether the Banquereau lands were included in the Settlement Agreement. The receiver took the position that the Banquereau lands were not part of the Settlement Agreement and by the time of trial had transferred them to a third party.

2. DECISION

Justice Bielby held that the receiver had represented to Taylor that the Settlement Agreement included the Banquereau lands because (i) the receiver prepared the June 8th List, which included the Banquereau lands, and titled it "Schedule "A" to the Settlement Agreement," (ii) the receiver's personnel who prepared the June 8th List understood that Taylor was entitled to all of Lochiel's available property and the Banquereau lands were still available, (iii) the receiver's actions in preparing the June 8th List was consistent with Taylor's counsel's evidence, (iv) the receiver did not contradict Taylor's counsel's evidence, (v) the receiver's senior personnel's evidence was inconsistent with the documentation (presumably the Settlement Agreement) prepared on his instructions by his solicitor and signed by him, and (vi) the receiver's senior personnel's evidence was not reliable.[73] A settlement was created by the receiver's oral acceptance of Taylor's February 12, 1990 offer to take the properties identified in the January 30th Letter. This agreement was subsequently amended to include the Banquereau lands as a result of the conversations which Taylor and his counsel had with the receiver, as well as the receiver's unqualified provision of a list that included the Banquereau lands.[74] Justice Bielby concluded that "[t]he discussions and exchanges of lists between Taylor [and his counsel] and [the receiver] in June 1990 rendered certain what which otherwise might have been uncertain due to the failure to attach Schedule A to the Settlement Agreement."[75]

Justice Bielby dismissed the receiver's argument of unilateral mistake because nothing in the facts put Taylor on notice of a possible mistake by the receiver's office.[76] She also dismissed the argument of mutual mistake because Taylor believed the Banquereau lands were included in the Settlement Agreement at the time he executed it.

With respect to the issue of damages, Justice Bielby held that because the Banquereau lands had been sold to a third party, damages were the only remedy available. After discussing the failings of various valuation models proposed by both parties' experts, she held that the

> most accurate valuation of Banquereau was placed upon it by Mr. Taylor himself in December, 1990 when he met with [the receiver] to discuss the problem which led to this litigation. Mr. Taylor testified that at that meeting, held shortly after the parties became aware of the breach he told [the receiver] that he thought Banquereau was worth between $20,000 to $100,000 nuisance value to Petro-Canada.[77]

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73 *Ibid.* at para. 31.
74 *Ibid.* at para. 33.
75 *Ibid.* at para. 34.
76 *Ibid.* at para. 32.
77 *Ibid.* at para. 61.

Justice Bielby awarded damages in the amount of $20,000 to Taylor.[78]

This case illustrates one approach taken by a court to resolve a dispute involving a purchase and sale agreement executed without its corresponding land schedule.

C. *MARTENS* v. *GULFSTREAM RESOURCES CANADA LTD.*[79]

This case examines a broker's right to a commission as a result of a disposition of interest, whether an exercise of a right of first refusal is a "sale," and whether the broker had to materially contribute to the cause of the sale. Justice Hart of the Alberta Court of Queen's Bench dismissed the plaintiff Martens' right to a commission. On October 12, 1999, the Alberta Court of Appeal dismissed Martens' appeal for the reasons given by Justice Hart.[80] Leave to appeal to the Supreme Court of Canada was applied for and dismissed June 29, 2000 with costs and without reasons.[81] The following discussion primarily reviews the decision of the Alberta Court of Queen's Bench.

1. FACTS

The action for commission arose out of a disposition of certain interests held by the defendant Gulfstream Resources Canada Ltd. ("Gulfstream") in an Exploration and Production Sharing Agreement ("EPSA") granted to the defendant and other companies by the government of Qatar for offshore exploration in the Arabian Gulf. The concession was effective April 10, 1976.

The facts surrounding the engagement of the plaintiff by Gulfstream to assist in finding buyers for Gulfstream's 10 percent interest in the EPSA are complicated. However, it is relevant to note that the plaintiff was engaged by the defendant by letter dated March 25, 1977. The plaintiff accepted the engagement and in turn engaged other consultants on behalf of the defendant to prepare reports and a comprehensive list of potential buyers for the 10 percent interest. The list included, amongst others, both Arco and British Gas. In the subsequent communications the plaintiff wrote a letter to the defendant in which it claimed that the listed companies were clients. There was no response to the letter in evidence from the defendant. Notably, through the plaintiff's efforts, British Gas expressed certain interest.

As a result of British Gas' interest, on April 14, 1982, the plaintiff advised the defendant by letter that British Gas had been on the original contact list, and that "if a deal should be made with British Gas, I have ... made the first contact and am consequently entitled to the agreed commission."[82] The plaintiff did not respond to this letter, and some time later, there were several communications from British Gas indicating that they were no longer interested in participating in the Qatar field in question. As a

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[78] *Ibid.* at paras. 64 and 67.

[79] (1998), 221 A.R. 252 (Q.B.) [hereinafter *Martens*].

[80] (1999), 250 A.R. 62 (C.A.), online: QL (AJ).

[81] [1999] S.C.C.A. No. 579, online: QL (SCCA).

[82] *Martens*, *supra* note 79 at 256.

result, the plaintiff renewed contact with British Gas. However, on January 10, 1992, British Gas advised the plaintiff that it was now in direct contact with the concession operator, Wintershall Aktiengesellschaft ("Wintershall"), and that it would be inappropriate to discuss matters with the plaintiff.

On March 31, 1994 Wintershall announced that it intended to assign its 35 percent interest to British Gas, to which Gulfstream responded by purporting to exercise a right of first refusal in order to acquire Wintershall's interest. Wintershall and others disputed the validity of the exercise of this right of first refusal.

Further rounds of negotiation resulted in a settlement on October 20, 1994 among the parties wherein Arco purchased a 21.1539 percent interest from Wintershall and a 6.3461 percent interest from Gulfstream. British Gas purchased a 13.8461 percent interest from Wintershall, and an 11.1539 percent interest from another party, and Arco replaced Wintershall as operator.

As a result of the settlement, the plaintiff wrote to the defendant on February 4, 1995, claiming a commission on the basis that, by the exercise of right of first refusal during arbitration, Gulfstream had increased its interest and then dropped its interest pursuant to the settlement. Therefore, the plaintiff argued, the defendant "sold" an interest to Arco and British Gas, thereby entitling the plaintiff to a commission. The defendant denied the commission on the basis that the sale to Arco was initiated in mid-1994 by a new management, and that the sale to British Gas was not made by the defendant, but rather, by Wintershall.

2. DECISION

Justice Hart identified the issues as:

(1) whether the Agreement between the plaintiff and the defendant had terminated prior to October 20, 1994, thus extinguishing any liability for payment of commission;

(2) characterizing the nature and effect of the agreement and the conditions on which the plaintiff became entitled to a commission; and

(3) whether the plaintiff was entitled to a remedy based on unjust enrichment with respect to the British Gas transaction.

Justice Hart held that the conduct of the plaintiff and the defendant, as well as the letters, indicated that prior to the transactions of 1994, the contract was in full force and effect according to its terms.

With respect to the nature of the agreement, the plaintiff had attempted to construe the agreement as an exclusive listing agreement. Justice Hart found no exclusive listing agreement language in evidence, and from comments in the contractual language referring

to "efforts of finding buyers" and "a conveyance ... through the agency of [the Plaintiff],"[83] Justice Hart concluded that a commission would be payable as long as the plaintiff materially contributed to the presentation of an offer or proposal which led to a sale. As there had been no effort on the plaintiff's behalf to complete the sale to Arco, Justice Hart found no contractual entitlement to a commission on the Arco sale.

With respect to the conveyance to British Gas, Justice Hart found that there were questions regarding the validity of the right of first refusal pursuant to which the defendant purported to increase its holdings, the exercise of which was followed by settlement negotiations. Therefore, there was no "sale" to British Gas within the meaning of the contract. Furthermore, Justice Hart found that notwithstanding the plaintiff's efforts to promote a sale to British Gas, the effect of these efforts had terminated when British Gas initially indicated that it was no longer interested in the Qatar field. Later contacts between the plaintiff and British Gas did not result in a material effect on the sale.

Justice Hart used the following language to characterize the effort required by an agent:

> It is obvious then that a mere introduction is of no assistance unless it actually arouses the interest of a purchaser. Similarly, if the purchaser loses the interest aroused by an agent, he has failed. The failure of an agent to produce sustained interest means he has done nothing useful. If the interest is later aroused again by the vendor or another, it is not as a result of the efforts of the agent.[84]

Therefore, there was no contractual obligation on the part of the defendant to pay a commission to the plaintiff.

Finally, Justice Hart held that this was not a situation of unjust enrichment. He noted that in order to find unjust enrichment, the plaintiff would need to show "injustice or want of commercial good conscience."[85] In this case such grounds had not been demonstrated. Similarly, Justice Hart held that *quantum meruit* was not available to the plaintiff as the relevant conditions had not arisen.[86]

This case provides a useful review of the law in Alberta with respect to commissions and sales of interests that might arise in an oil and gas setting.

D. *M.J.B. ENTERPRISES LTD.* v. *DEFENCE CONSTRUCTIONS (1951) LTD.*[87]

In this case the Supreme Court of Canada analyzes and rationalizes the law of bids and tenders. Given the importance of calls for bids in the petroleum industry, this case is of interest to oil and gas lawyers.

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83 *Ibid.* at 260.
84 *Ibid.* at 262 citing *Doherty Bros. Realty Ltd.* v. *Ruffo and Ruffo* (1980), 24 A.R. 326 (Q.B.) at 331 [hereinafter *Doherty Bros.*].
85 *Martens*, *ibid.* at 263.
86 See *Doherty Bros.*, *supra* note 84.
87 (1999), 170 D.L.R. (4th) 577 (S.C.C.) [hereinafter *M.J.B.*].

1. FACTS

Defence Construction (1951) Limited ("Respondent") invited tenders for the construction of a pump house, the installation of a water distribution system, and the dismantling of a water tank. Four tenders were received, including that of the plaintiff applicant. The detailed tender instructions contained a typical "privilege clause," which contained the words: "the lowest of any tender shall not necessarily be accepted."[88] The contract was awarded to Sorochan Enterprises Ltd. ("Sorochan"), the lowest tenderer. The applicant's tender was the second lowest tender.

At issue was Sorochan's response to a tender condition that required a single price per linear metre for land fill to be used in construction. Three fill alternatives were available in the call for bid, but only one was to be chosen. Sorochan's tender provided a price for one fill but gave a second price should one of the alternative fills have been required.

The plaintiff submitted the next lowest bid, and argued that Sorochan's tender was invalid as it did not meet the single price requirement of the tender documents. It further argued that its bid, as the next lowest, should have been accepted.

2. DECISION

The Supreme Court of Canada's analysis in this matter follows the "Contract A/ Contract B" analysis developed by the Court in *Ron Engineering and Construction (Eastern) Ltd.* v. *Ontario*.[89] This analysis in *Ron Engineering* held that in a bid and tender situation, a unilateral contract, Contract A, arose upon tender documents being submitted by potential bidders. *Ron Engineering* had been interpreted to stand for the proposition that Contract A is always formed upon the submission of a tender, and that a term of a contract was the irrevocability of the tender.[90] Academic commentary on the point varied, and attempts to overcome this result were made by the inclusion of privilege clauses which reserve the right of the tender recipient to select other than the lowest bid.

Justice Iacobucci, on behalf of a unanimous seven-judge panel in *M.J.B.*, rejected the interpretation of *Ron Engineering* that Contract A is always irrevocably formed upon the submission of a tender. He held that a bid submitted in a tendering context is not always irrevocable, and that the irrevocability of a bid arises out of the terms of the tender. Based on this, Justice Iacobucci further held that it is possible that Contract A does not arise on the submission of a tender, or that it arises but that the irrevocability of the tender is not one of its terms, either depending on the terms and conditions of the tender call. He then explicitly stated that "to the extent that *Ron Engineering* suggests otherwise, I decline to follow it."[91] He also stated that he did "not wish to be taken to endorse Estey J.'s

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88 *Ibid.* at 580.

89 [1981] 1 S.C.R. 111 [hereinafter *Ron Engineering*].

90 See also N. Rafferty, "Developments in Contract and Tort Law: the 1998 - 99 Term," (2000) 11 S.C.L.R. (2d) 183.

91 *M.J.B.*, *supra* note 87 at 585.

characterization of Contract A as a unilateral contract in *Ron Engineering*."[92] His conclusion is that

> what is important, therefore, is that the submission of a tender in response to an invitation to tender may give rise to contractual obligations, quite apart from the obligations associated with the construction contract to be entered into upon the acceptance of a tender, depending on whether the parties intend to initiate contractual relations by the submission of a bid.[93]

Justice Iacobucci, having decided that the Contract A / Contract B analysis applied as interpreted above, then examined whether in this case there was an explicit obligation in Contract A to award Contract B to the lowest valid tender. He found that there was no such explicit obligation in the written documentation, but that it was an implied term that only a compliant bid may be accepted. This implied term arose from the actual intention of the parties, which may be assessed by the application of a business efficacy approach or an "officious bystander" test. On this basis, Justice Iacobucci held that while the contractors would likely only have submitted a bid on the basis that only a *compliant* tender would be accepted, he found no "support for the proposition that, in the face of a privilege clause such as the one at issue in this case, the *lowest* compliant tender was to be accepted."[94]

He then went on to consider whether the privilege clause overrode the implied term that only compliant bids would be accepted. In this respect, he held that the privilege clause is consistent with the obligation to accept only compliant bids. While rejecting that a tender could be accepted on the basis of some undisclosed criterion, Justice Iacobucci stated that "the discretion to accept not necessarily the lowest bid, retained by the owner by the privilege clause, is a discretion to make a more nuanced view of 'cost' than the prices quoted in tenders."[95] This would accommodate circumstances where, for example, a bid other than the lowest bid may result in cost savings as a result of other aspects of that bid. Therefore, the "privilege clause is compatible with the obligation to accept only a compliant bid ... however, the privilege clause is incompatible with an obligation to accept only the lowest compliant bid. With respect to this latter proposition, the privilege clause must prevail."[96]

Having found that the Respondent was under no contractual obligation to award the contract to the appellant as the tenderer of the lowest compliant bid, Justice Iacobucci nevertheless found a breach of Contract A. The breach arose because the defendant, in awarding the contract to the lowest actual bidder, accepted a bid that was non-compliant. This of course breached the obligation to accept only a compliant tender.

Therefore, Justice Iacobucci held that, as Contract A had been breached, the appellant was entitled to damages. The damages were to be calculated by considering whether, on

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[92] *Ibid.*
[93] *Ibid.*
[94] *Ibid.* at 588 [emphasis in original].
[95] *Ibid.* at 594.
[96] *Ibid.*

the balance of probabilities, the appellant would have been awarded the contract. Justice Iacobucci then found that the appellant was entitled to damages pursuant to the classical test for remoteness, which reads:

> Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered arising naturally, *i.e.*, according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of the parties, at the time they made the contract, as the probable result of the breach of it.[97]

This case is an important development in the law relating to bids and tenders, and will have an impact on the oil and gas industry where calls for bids are used extensively. It marks a retrenchment from, but not a complete rejection of, the common interpretation of the principles set out in the often criticized case of *Ron Engineering.*

V. ABORIGINAL RIGHTS

A. *R.* v. *MARSHALL*

The Supreme Court of Canada decision in *R.* v. *Marshall* generated widespread reaction throughout Canada. Perhaps the most interesting aspect of this case for oil and gas lawyers is what the Court stated, in an application for rehearing, that it did not intend in its appeal decision.

1. FACTS

Marshall, a Mi'kmaq Indian, was charged under the *Fisheries Act*[98] for fishing for eels out of season and without a licence. He defended those charges by asserting a right to fish under a 1760 Mi'kmaq treaty. The Crown, before all levels of court, neither adduced evidence nor argued that infringement of the alleged treaty was justified. The Crown's case was simply that no such treaty right existed. The trial court held that Marshall's treaty rights did not include a right to fish or hunt and, in any event, that those treaty rights had expired in the 1780s.[99] The Nova Scotia Court of Appeal affirmed the trial court decision.[100]

2. SUPREME COURT OF CANADA APPEAL DECISION[101]

On September 17, 1999, the Supreme Court of Canada (McLachlin and Gonthier, JJ. dissenting) reversed the lower court decisions and acquitted Marshall on the basis that the Mi'kmaqs did indeed have surviving treaty rights to "continue to obtain necessaries through hunting and fishing by trading the products of those traditional activities subject

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97 *Ibid.* at 598 citing *Hadley* v. *Baxendale* (1854), 9 Ex. 341.

98 R.S.C. 1985, c. F-14.

99 [1996] N.S.J. No. 246 at paras. 117 and 125-27, (Prov. Ct.), online: QL (NSJ).

100 (1997), 146 D.L.R. (4th) 257 (N.S. C.A.).

101 (1999), 177 D.L.R. (4th) 513 (S.C.C.) [hereinafter *Marshall Appeal*].

to restrictions that can be justified under the *Badger* test."[102] The issue of whether the regulation of those treaty rights under the *Fisheries Act* was in accordance with the *Badger* test was not argued. Having found that there were existing treaty rights, Justice Binnie, for the majority, concluded as follows:

> [Marshall] caught and sold the eels to support himself and his wife. Accordingly, the close season and the imposition of a discretionary licensing system would, if enforced, interfere with the appellant's treaty right to fish for trading purposes, and the ban on sales would, if enforced, infringe his right to trade for sustenance. In the absence of any justification of the regulatory prohibitions, [Marshall] is entitled to an acquittal.[103]

Following Marshall's acquittal, an application was made by an intervener, the West Nova Scotia Fishermen's Coalition ("Coalition"), for a rehearing of the Supreme Court's decision, seeking clarification insofar as it related to the Crown's power to regulate fisheries in relation to Marshall's specific treaty rights and Mi'kmaq treaty rights in general. It appears that the Coalition's intervention and application arose out of its interests in the lobster fishery.

3. SCC REHEARING DECISION[104]

The Court held that the Coalition's application did not meet the "exceptional circumstance" test required for a rehearing application by an intervener and was not based upon the appeal record.[105] The Court also took the opportunity to clarify a number of apparent "misunderstandings" of its decision.[106] In relation to the Mi'kmaq's "hunting, gathering and fishing" treaty rights discussed above, the Court stated the following:

> Certain unjustified assumptions are made in this regard by the Native Council of Nova Scotia on this motion about "the effect of the economic treaty right on forestry, *minerals and natural gas deposits offshore*." The Union of New Brunswick Indians also suggested on this motion a need to "negotiate an integrated approach dealing with all resources coming within the purview of fishing, hunting and gathering which includes harvesting from the sea, the forests and the land." *This extended interpretation of "gathering" is not dealt with in the September 17, 1999 majority judgment, and negotiations with respect to such resources as logging, minerals or offshore natural gas deposits would go beyond the subject matter of this appeal.*
>
> The September 17, 1999 majority judgment did not rule that the appellant had established a treaty right "to gather" anything and everything physically capable of being gathered. The issues were much narrower and the ruling was much narrower. *No evidence was drawn to our attention, nor was any argument made in the course of this appeal, that trade in logging or minerals, or the exploitation of off-shore natural gas deposits, was in the contemplation of either or both parties to the 1760 treaty; nor was the argument*

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102 *Ibid.* at 546 (S.C.C.). The *Badger* test is discussed by Justice Binnie at 549 of the *Marshall Appeal* decision.

103 *Ibid.* at 550.

104 (1999), 179 D.L.R. (4th) 193 (S.C.C.) [hereinafter *Marshall Rehearing*].

105 *Ibid.* at 199-200.

106 *Ibid.* at 200.

> *made that exploitation of such resources could be considered a logical evolution of treaty rights to fish and wildlife or to the type of things traditionally "gathered" by the Mi'kmaq in a 1760 aboriginal lifestyle.*[107]

Therefore, to the extent that it was not clear that the *Marshall Appeal* decision did not pertain to natural resources, such as minerals and offshore natural gas rights, this is confirmed by the *Marshall Rehearing* decision.

VI. ENVIRONMENTAL LAW

A. *FRIENDS OF THE WEST COUNTRY ASSOCIATION* V. *CANADA (MINISTER OF FISHERIES AND OCEANS)*[108]

Proponents of energy projects can take guidance from the Federal Court of Appeal's decision in *Friends of the West Country Association* v. *Canada*, or the "*Sunpine*" decision as it is commonly called, insofar as it defines and circumscribes the required scope of an environmental assessment conducted under the *Canadian Environmental Assessment Act*.[109]

1. FACTS

In late 1995, Sunpine Forest Products Ltd. ("Sunpine") applied to the Canadian Coast Guard, Navigable Waters Protection Division ("Coast Guard") pursuant to the *Navigable Waters Protection Act*[110] for approval to construct a bridge over Prairie Creek and a bridge over the Ram River. The bridges would connect a proposed "Mainline Road" running to Sunpine's mill near Strachan, Alberta. Because Sunpine needed to obtain *Navigable Waters Protection Act* approvals for the bridges, the requirement for a federal environmental assessment under the *CEAA* was triggered.

The Coast Guard, as the "responsible authority" under the *CEAA*, issued screening reports for each of the bridges, including addenda following receipt of public comments. Following a revision to the construction plans for the Ram River bridge, the Coast Guard issued a further screening report. The screening reports concluded that the proposed bridges were not likely to cause significant adverse environmental effects. Consequently, the applied-for approvals to construct the Prairie Creek and Ram River bridges were issued by the Coast Guard. The Friends of the West Country Association ("Association") applied for judicial review of the screening reports and the approvals.

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[107] *Ibid.* at 205 [emphasis added].

[108] (1999), 248 N.R. 25 (F.C.A.) [hereinafter *Sunpine*].

[109] S.C. 1992, c. 37 [hereinafter *CEAA*].

[110] R.S.C. 1985, c. N-22, s. 5(1).

2. DECISION AT THE FEDERAL COURT TRIAL DIVISION[111]

After starting from the proposition that a broad interpretation of the application of *CEAA* is mandated, Justice Gibson applied the "independent utility test" from American jurisprudence to determine that "the bridges constituting the projects here under review were to form integral parts of a forestry road."[112] He then concluded that

> the environmental assessments conducted were deficient in two fundamental respects: first, they were not conducted in respect of a construction or other undertaking, namely, the Mainline Road, that was a construction or other undertaking "in relation to" the projects, as defined, and that was proposed by the proponent; and, secondly, they failed to include consideration of the cumulative environmental effects likely to result from each project in combination with another project that had been or would be carried out, once again, the Mainline Road.
>
> ...
>
> I make no finding with respect to the question of whether the scope of the environmental assessments should have extended to the environmental effects of the proponent's proposed forestry operations and the operations on the road and bridges because I need not do so. That being said however, it would appear clear that a generous reading of the CEAA would require the extension of the environmental assessment to cover the likely environmental effects of those operations as well.[113]

Justice Gibson also found that the establishment and maintenance of the public registry containing records related to the Sunpine environmental reviews in Sarnia, Ontario did not comply with s. 55 of *CEAA* since it did not ensure convenient public access for concerned members of the public (*i.e.*, Albertans).[114]

In the result, Justice Gibson ordered that the approvals be set aside, and the matter was referred back for redetermination.[115]

3. DECISION AT THE FEDERAL COURT OF APPEAL

The issues before the Federal Court of Appeal involved the interpretation and application of ss. 15, 16, and 55 of *CEAA*. With respect to s. 15,[116] the issue was

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111 [1998] 4 F.C. 340 (T.D.).

112 *Ibid.* at 362.

113 *Ibid.* at 371.

114 *Ibid.* at 372.

115 Justice Gibson's decision was not, however, followed by Justice Nadon in *Manitoba's Future Forest Alliance* v. *Canada (Minister of the Environment)* (1999), 30 C.E.L.R. (N.S.) 1 (F.C.T.D.), whose decision predates the Federal Court of Appeal's decision in the *Sunpine* case. The case before Justice Nadon was remarkably similar to the *Sunpine* case. It too considered whether s. 15(3) of the *CEAA* required the Coast Guard to include in its environmental assessment access roads and a larger forestry project in conjunction with a bridge authorized pursuant to the *Navigable Waters Protection Act*.

116 Section 15 reads as follows:

> 15(1) The scope of the project in relation to which an environmental assessment is to be conducted shall be determined by
>
> (a) the responsible authority

whether the Coast Guard's determination of the scope of the project subject to the environmental assessment was reviewable. In all of the screening reports, the Coast Guard defined the scope of the "projects" subject to environmental review as the bridges themselves "including associated approaches and related works, storage areas or other undertakings directly associated with the construction of these bridges."[117] The scope of the projects did not include the Mainline Road or Sunpine's forestry operations.

Justice Rothstein, for the Federal Court of Appeal, agreed with the lower court's finding that there was no reviewable error in how the Coast Guard exercised its discretion in defining the projects subject to environmental assessment under s. 15(1). However, approaching the issue from the perspective of statutory interpretation, he disagreed with the trial court's finding that s. 15(3) imposed a mandatory duty on the Coast Guard to consider physical works outside of the scope of project established by it under s. 15(1):

> As I see the scheme of ss. 15(1) and 15(3) in relation to this case, the responsible authority first determines the scope of a project under s. 15(1). Section 15(3) is subsidiary to s. 15(1). Section 15(3) requires the responsible authority to conduct its environmental assessment in respect of the various aspects of the project.[118]

After noting the similarity between the definition of "project" in s. 2[119] and the scope of the environmental assessment in s. 15(3), Justice Rothstein concluded that "the environmental assessment that must be carried out will be in respect of the project as scoped. In other words, s. 15(3) does not impose an obligation on the responsible authority to conduct an environmental assessment outside the scope of the projects as determined under s. 15(1)."[120] Consequently, s. 15(3) did not require the Coast Guard to include either the Mainline Road or Sunpine's forestry operations in the environmental assessment.[121]

...

15(3) Where a project is in relation to a physical work, an environmental assessment shall be conducted in respect of every construction, operation, modification, decommissioning, abandonment or other undertaking in relation to that physical work that is proposed by the proponent or that is, in the opinion of
(a) the responsible authority...
likely to be carried out in relation to that physical work.

117 *Sunpine*, *supra* note 108 at 32.

118 *Ibid.* at 33.

119 Under s. 2, "project" is defined as including
(a) in relation to a physical work, any proposed construction, operation, modification, decommissioning, abandonment or other undertaking in relation to that physical work....

120 *Sunpine*, *supra* note 108 at 34.

121 See also *Citizens' Mining Council of Newfoundland and Labrador Inc.* v. *Canada (Minister of the Environment)* (1999), 29 C.E.L.R. (N.S.) 117 (F.C.T.D.) which involved the interrelationship between Inco Limited's Voisey's Bay nickel mine and the Argentia smelter/refinery insofar as s. 15(3) of the *CEAA* was concerned. In that case, which was decided after Justice Gibson's decision but before Justice Rothstein's decision, Justice MacKay held that s. 15(3) did not require a single environmental assessment when two projects are proposed even if those projects are somewhat interrelated. He stated the following at 140-41:

> Those are circumstances included within s-s. 15(2), which authorizes one assessment in respect of two or more projects where the responsible authority or the Minister of Environment

The issue relating to s. 16 of the *CEAA*[122] was whether the Coast Guard was required to consider the Mainline Road as part of its cumulative effects assessment. In that regard, the Coast Guard in the screening reports and subsequent addenda, restricted its cumulative effects assessment to only the project (*i.e.*, the bridges and associated approaches and related works, *etc.*). Justice Rothstein held that the mandatory language contained in s. 16(1) required that the Coast Guard consider the environmental effect of the projects, including cumulative effects pursuant to s. 16(1)(a) resulting from the combination of the projects with other existing or future projects or activities.[123] However, the Coast Guard has the discretion pursuant to s. 16(3) to determine the scope of the factors to be considered under s. 16(1)(a), among other sections. Consequently, it was "within the discretion of the responsibility authority [the Coast Guard] to decide which other projects or activities to include and which to exclude for purposes of a cumulative environmental effects assessment under s. 16(1)(a)."[124] Because the screening reports did not expressly state that the Mainline Road and Sunpine's forestry operations were not other projects being considered within the cumulative effects assessment, the Court concluded that the Coast Guard declined to consider matters outside of the scope of the project or its federal jurisdiction. In doing so, the Coast Guard misinterpreted ss. 16(1)(a) and 16(3) thus committed a reviewable error of law.[125]

With respect to s. 55 of the *CEAA*,[126] Justice Rothstein agreed with the trial court in finding that a registry established in Sarnia did not comply with the *CEAA* since it was

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> determines that the projects are so closely related that they can be considered a single project. That determination is clearly discretionary, not one bound by statute.
>
> ...
>
> Here two projects were proposed by [Inco Limited's subsidiary], which treats them as separate projects, and it sought necessary approvals at different times, by different responding authorities. In these circumstances, in my opinion if the two are to be combined within a single environmental assessment under the *Act*, a determination to do so must be made under s-s. 15(2).

122 Section 16(1) reads:

> 16(1) every screening or comprehensive study of a project ... shall include a consideration of the following factors:
>
> (a) the environmental effects of the project, including the environmental effects of malfunctions or accidents that may occur in connection with the project and any cumulative environmental effects that are likely to result from the project in combination with other projects or activities that have been or will be carried out;
>
> (b) the significance of the effects referred to in paragraph (a)
>
> ...
>
> 16(3) The scope of the factors to be taken into consideration pursuant to paragraphs (1)(a), (b) and (d) and 2(b), (c) and (d) shall be determined
>
> (a) by the responsible authority

123 *Sunpine*, *supra* note 108 at 36.

124 *Ibid.*

125 *Ibid.* at 38 and 41.

126 Section 55 reads:

> 55(1) For the purpose of facilitating public access to records relating to environmental assessments, a public registry shall be established and operated in a manner to ensure convenient public access to the registry and in accordance with this Act and the regulations in respect of every project for which an environmental assessment is conducted.

not in close proximity to the relevant geographic area of the environmental assessment or alternatively did not allow for other reasonable means of access, such as e-mail, faxes, or maintaining a set of materials with a local agent.

In the result, the appeal was dismissed and the matter directed to be redetermined. An application for leave to appeal to the Supreme Court of Canada has been made by the Association.[127] As of August 16, 2000, that application had yet to be ruled upon.

B. *ALBERTA WILDERNESS ASSN.* v. *CARDINAL RIVER COALS LTD.*[128]

1. FACTS

Cardinal River Coals Ltd. ("CRC") submitted concurrent applications to the Alberta Energy and Utilities Board ("EUB") and the federal Department of Fisheries and Oceans ("DFO") seeking authorization to construct an open pit coal mine east of Jasper National Park ("Project"). The Project involved thirty or more open pits and associated infrastructure, such as access roads, rail lines, as well as a new electric substation and transmission line. Because certain portions of the Project, if constructed, would impact fish habitat, a DFO application pursuant to s. 35(2) of the *Fisheries Act*[129] was made to obtain ministerial authorization before altering, disrupting, or destroying fish habitat. As a result of the CRC's *Fisheries Act* application to impact fish habitat, the requirement for an environmental assessment under to the *CEAA* was triggered.

A comprehensive study was initially commenced under the *CEAA*, however, before that study was completed the Minister of Fisheries and Oceans ("Minister") referred the matter to a *CEAA* panel review. Since an environmental impact assessment was also required under Alberta legislation, the federal Minister of the Environment and the EUB agreed to conduct a joint review and entered into an "Agreement for the Cheviot Coal Project" dated October 24, 1996 ("Joint Panel Agreement"). The Joint Panel Agreement established the "Joint Review Panel," composed of two members of the EUB appointed by Alberta, and one federal appointment. The Joint Panel Agreement also set out the terms of reference, including the factors to be considered in the environmental impact assessment.

The Joint Review Panel conducted extensive oral hearings and issued its report and recommendations ("Report") which recommended that the Minister approve the Project and issue the necessary *Fisheries Act* approvals. The Minister, with the approval of the Governor in Council, issued a response to the Report indicating that *Fisheries Act* authorizations for the Project would be issued ("Minister's Response").[130]

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127 [1999] S.C.C.A. No. 585, online: QL (SCCA).

128 (1999), 15 Admin. L.R. (3d) 25 (F.C.T.D.) [hereinafter *Cardinal River*].

129 *Supra* note 98.

130 *Cardinal River Coals Ltd. Cheviot Coal Project* (6 June 1997), Decision 97-8 (E.U.B.).

2. DECISION OF THE FEDERAL COURT TRIAL DIVISION[131]

The Alberta Wilderness Association and others (collectively "AWA") applied for judicial review of the Report. Justice McKeown held that the Joint Review Panel did not exercise any power to make a final decision. Rather, it was the Minister who, as responsible authority, made the final decision. Consequently, the applicant's failure to challenge the Minister's Response, as opposed to the Report, in a court of competent jurisdiction was a complete bar to the AWA's application.[132]

3. DECISION OF THE FEDERAL COURT OF APPEAL[133]

The AWA appealed. Justice Sexton, for the Court, allowed the appeal finding that

> [t]he requirements of CEAA are legislated directions that are explicit in mandating the necessity of an environmental assessment as a prerequisite to Ministerial action. It is clear that the Minister has no jurisdiction to issue authorizations in the absence of an environmental assessment. It is equally clear that any assessment must be conducted in accordance with the Act, including for example, the requirement imposed under s. 16 of CEAA. The fact that a federal response has been issued and remains unchallenged does not change these requirements.
>
> ...
>
> I believe that the proper approach of the applications judge should have been, on the assumption that an environmental assessment in accordance with CEAA was an essential prerequisite to the issuance of any authorizations of the Minister, to proceed to analyze the arguments advanced by the appellants, in order to decide whether a proper environmental assessment had been conducted by the Joint [Review] Panel.[134]

The Court remitted the matter back to the trial court for reconsideration in conjunction with a separate application for judicial review of the *Fisheries Act* authorizations issued by the Minister in the meantime.

4. REHEARING DECISION OF THE FEDERAL COURT TRIAL DIVISION[135]

On rehearing, the trial court considered whether (i) the Joint Review Panel complied with the *CEAA* and the Joint Panel Agreement, (ii) the Joint Review Panel failed to comply with the rules of procedural fairness, and (iii) the Minister was prohibited from issuing the *Fisheries Act* approvals because of an alleged contravention of law. The Court found that on the first two issues the Joint Review Panel had erred in law and referred the

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131 *Alberta Wilderness Assn.* v. *Canada (Minister of Fisheries and Oceans)* (1998), 152 F.T.R. 49.

132 *Ibid.* at paras. 27, 28, and 36.

133 *Alberta Wilderness Association* v. *Canada (Minister of Fisheries and Oceans)* (1998), 238 N.R. 88 (F.C.A.).

134 *Ibid.* at 93-94.

135 *Cardinal River*, *supra* note 128.

matter back to the Joint Review Panel for reconsideration consistent with certain directions. Each of these issues is discussed in more detail below.

a. Did the Joint Review Panel comply with the *CEAA* and the Joint Panel Agreement?

Justice Campbell began his analysis with a thorough review of the applicable *CEAA* provisions and the duties incumbent upon a *CEAA* review panel, such as the Joint Review Panel.[136] He found that the Joint Review Panel had three duties to meet that were specific to the environmental review. First, the Joint Review Panel had a "consideration duty" to consider the various factors enumerated in the *CEAA* under ss. 16(1) and (2). In fulfilling its consideration duty, the Joint Review Panel is required to meet a high standard of care.[137] Second, the Joint Review Panel was held to have an "information gathering duty" under s. 34(a) of the *CEAA* and under similar provisions in the Joint Panel Agreement "to obtain *all available information* that is required to conduct the environmental assessment."[138] On this point, Justice Campbell also found that

> what is "required" is that which will meet the just found high standard of care respecting consideration of the section 16 factors, and the onerous evidence gathering duty on the Joint Review Panel.
>
> ...
>
> [T]he information gathering duty of the Joint Review Panel does not depend on the project proponent CRC's information gathering success, nor does it depend on that of any intervenor or interested party. The duty is the Joint Review Panel's to meet.[139]

Third, the Joint Review Panel was held to have a "reporting duty" which required it to substantiate its recommendations with reference to the evidence and, only in circumstances where evidence is either not available, or is inaccessible, may the Joint Review Panel "fill the gaps" with its own expert opinion. Justice Campbell referred to s. 35 of *CEAA*, which empowers a review panel to compel the production of evidence, including confidential information, and held that in the present circumstances, where the Joint Review Panel was aware of evidence relevant to one of the factors set out in s. 16, it has a duty to exercise those powers to compel production rather than relying upon its own expert opinion to "fill the gaps."[140]

Justice Campbell then considered whether the Joint Review Panel breached any of the foregoing three duties in the context of its consideration of cumulative effects pursuant to s. 16(1)(a) and "alternate means" pursuant to s. 16(2)(b). With respect to cumulative

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136 It was apparently uncontested that the applicable standard of review for the alleged errors of law was correctness. Justice Campbell also held that for an exercise of discretion the applicable standard was reasonableness (*ibid.* at 36). Having regard to recent decisions of the Supreme Court of Canada, including the decision in *Baker*, *infra* note 145, which was subsequent to *Cardinal River*, it is certainly arguable the Joint Review Panel was entitled to a higher degree of deference and, in any event, the standard of review for an exercise of discretion and an error of law should both be determined using the same pragmatic and functional approach.

137 *Cardinal River*, *supra* note 128 at 42.

138 *Ibid.* at 43 [emphasis in original].

139 *Ibid.*

140 *Ibid.* at 45.

effects, the Court noted that the Joint Review Panel wrongfully accepted CRC's submission that cumulative effects information from industry sources was unobtainable and CRC's surrogate data used to substantiate the position that other developments in the area would have no significant impact.[141] Evidence filed in the Federal Court (but apparently not with the Joint Review Panel) "conclusively proved" that extensive logging and road building would take place in and around the mine site. Justice Campbell held that the Joint Review Panel's misapprehension of the level of logging and road building led it to make an erroneous assumption regarding the amount of forest cover that would remain for ungulate habitat in the mine area. He also held that the Joint Review Panel failed to require production of disclosure documents relating to other coal mine projects filed with Alberta pursuant to the provincial coal development policy. As a result, the Joint Review Panel was held to have breached its information gathering duty insofar as it did not obtain all available information about likely forestry and mining activities in the area.[142]

Section 16(2)(b) requires a review panel to consider the "alternative means of carrying out the project that are technically and economically feasible and the environmental effects of any such alternative means." Justice Campbell held that, notwithstanding that CRC's Alberta regulatory applications and environmental impact assessment were for an open pit mine, s. 16(2)(b) still required the Joint Review Panel to consider underground mining as an alternative to open pit mining, including an assessment of the comparative environmental effects.

b. Did the Joint Review Panel fail to comply with the rules of procedural fairness?

This issue involved two written submissions made to the Joint Review Panel by the Canadian Nature Federation. Justice Campbell held that in making those submissions a "legitimate expectation" was created to the effect that the submissions would be placed before the Joint Review Panel for consideration. However, the Report did not refer to the Canadian Nature Federation's submissions, nor identify it on the exhibit list. Consequently, the Court held that the Joint Review Panel committed a reviewable error by failing, on the balance of probabilities, to consider information that it received.[143]

c. Was the Minister prohibited from issuing the *Fisheries Act* approvals because of an alleged contravention of law?

This issue involved a consideration of whether the Minister could issue a *Fisheries Act* approval if it had the effect of contravening the *Migratory Birds Convention Act* Regulations.[144] Section 35(1) of the *MBCA Regs* prohibits the deposit of "any other substance harmful to migratory birds in any waters or any area frequented by migratory birds." Justice Campbell held that the millions of tonnes of rock that would be deposited into creek beds could constitute a threat to the preservation of migratory birds nesting near

141 *Ibid.* at 49-50.
142 *Ibid.* at 51 and 53.
143 *Ibid.* at 56.
144 *Migratory Birds Regulation*, C.R.C., c. 1035 (1978) [hereinafter the *MBCA Regs*].

the Project within the meaning of s. 35(1). However, the application of s. 35(1) to the Minister's decision was uncertain since the Governor in Council could make new regulations pursuant to s. 35(2) exempting the present case.

Hearings reconvened before the Joint Review Panel in April 2000. As of August 15, 2000, the Joint Review Panel has yet to issue its report on the matters referred back to it by Justice Campbell.

VII. ADMINISTRATIVE LAW

A. *BAKER V. CANADA (MINISTER OF CITIZENSHIP AND IMMIGRATION)*[145]

While this case arises out of an immigration matter, it is of interest to oil and gas lawyers because of the comments of the Supreme Court of Canada regarding the limits within which a court may exercise a review of an administrative tribunal's discretion.

1. FACTS

Mavis Baker, a Jamaican citizen living in Canada, was ordered deported after it was determined that she had been working illegally in Canada and had overstayed her visa. Baker then applied for an exemption based on humanitarian and compassionate grounds to allow her to apply for permanent residence while still in Canada; normally, such applications must be made from abroad. The grounds for Baker's application related to concerns that medical treatment may not be available to her in Jamaica and to the effect that her departure may have on her Canadian-born children. Legal counsel assisted Baker in the preparation of her application and letters from her doctor and a social worker were filed in its support.

Baker's exemption application was denied by way of a letter signed by an immigration officer. That letter stated that there were insufficient humanitarian and compassionate grounds to warrant processing Baker's application for permanent residence within Canada, but did not set out the reasons for that decision. Baker's counsel requested and received a copy of the notes of a subordinate reviewing officer used by the immigration officer when making the decision. Baker then applied for judicial review of the Immigration officer's decision. The trial court dismissed the application and the matter was ultimately appealed to the Supreme Court of Canada.

2. DECISION

Justice L'Heureux-Dubé, writing for the majority, addressed issues relating to the *Immigration Act*,[146] procedural fairness and administrative discretion. As noted above, the discussion relating to administrative discretion is of particular interest here.

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[145] (1999), 174 D.L.R. (4th) 193 (S.C.C.) [hereinafter *Baker*].

[146] R.S.C. 1985, c. I-2.

Administrative discretion is defined as "decisions where the law does not dictate a specific outcome, or where the decision-maker is given a choice of options within a statutorily imposed set of boundaries."[147] The *Baker* case represents a departure from past jurisprudence whereby decisions classified as discretionary could only be reviewed on limited grounds, such as bad faith, exercise for an improper purpose, or irrelevant considerations. Justice L'Heureux-Dubé recognized the difficulty faced in categorizing an administrative decision as being either wholly discretionary or non-discretionary, and consequently the uncertainty of the applicable standard of review. Instead, she posits the application of a "pragmatic and functional" approach that has been established for determining the standard of review on a statutory appeal for errors of law and, presumably, for mixed law and fact. That is, the applicable standard of review for an error of law falls on a spectrum from "patent unreasonableness" to "reasonableness *simpliciter*" to "correctness" having regard to a number of factors dictating the degree of *curial* deference a court should afford the administrative tribunal in question:[148]

> The pragmatic and functional approach takes into account considerations such as the expertise of the tribunal, the nature of the decision being made, and the language of the provision and the surrounding legislation. It includes factors such as whether a decision is "polycentric" and the intention revealed by the statutory language. The amount of choice left by Parliament to the administrative decision-maker and the nature or the decision being made are also important considerations in the analysis. The spectrum of standards of review can incorporate the principle that in certain cases, the legislature has demonstrated its intention to leave greater choices to decision-makers than in others, but that a court must intervene where such a decision is outside the scope of the power accorded by Parliament.[149]

Justice L'Heureux-Dubé held that the standard of review in the present case was "reasonableness *simpliciter*" given that: (i) the *Immigration Act* did not contain a privative clause, (ii) the decision-maker was the Minister of Citizenship and Immigration or his or her delegate who has some expertise in immigration matters, (iii) the purpose of the applicable provision of the *Immigration Act* is an exemption from the requirements of the Act or its regulations, recognizing that an exemption decision relates directly to the rights and interests of an individual, and (iv) the nature of a humanitarian and compassionate exemption decision is fact specific, not involving any legal interpretation.[150] She went on to find that the immigration officer's decision was unreasonable in the sense contemplated by the definition of "unreasonable" set out in *Southam* case[151] because "[t]he officer was completely dismissive of the interests of Baker's children."[152]

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147 *Baker*, *supra* note 145 at 223.

148 For example, see *Canada (Director of Investigation and Research)* v. *Southam Inc.*, [1997] 1 S.C.R. 748 at 778 [hereinafter *Southam*].

149 *Baker*, *supra* note 145 at 225-26.

150 *Ibid.* at 226-28.

151 *Southam*, *supra* note 148 at 776, where Justice Iacobucci for the Court stated that "[a]n unreasonable decision is one that, in the main, is not supported by any reasons that can stand up to a somewhat probing examination. The defect, if there is one, could presumably be in the evidentiary foundation itself or in the conclusions are sought to be drawn from it."

152 *Baker*, *supra* note 145 at 229.

Therefore, the *Baker* case establishes a new framework for determining the standard of review relating to the exercise of an administrative tribunal's discretion. The standard of review for matters clearly within a tribunal's jurisdiction will now be determined on the same basis as matters relating terms of law or mixed law and fact. With respect to the standard of review relating to discretionary decisions made by provincial and federal energy and environmental regulators within the ambit of their respective statutory jurisdiction, we believe that the standard of "patent unreasonableness" will likely continue to prevail. Regulators such as the National Energy Board and the Alberta Energy and Utilities Board, which have privative clauses in many of their enabling statutes, are generally recognized to be expert tribunals and hear matters that are largely fact specific.[153]

B. *UNION OF NOVA SCOTIA INDIANS* V. *MARITIMES AND NORTHEAST PIPELINE MANAGEMENT LTD.*

The *Maritimes and Northeast Pipeline Management Ltd.* (M&NP) *M&NP (No. 1)* and *M&NP (No. 2)* cases consider two issues, both arising out of a challenge to the certification of the Maritimes and Northeast Pipeline Project ("M&NP Project"). In *M&NP (No. 1)* Justice Noël, for the Federal Court of Appeal, considered whether s. 18.5 of the *Federal Court Act*[154] was a bar to the judicial review application brought by, among others, the Union of Nova Scotia Indians ("UNSI"). In *M&NP (No. 2)* Justice Rothstein, for the Federal Court of Appeal, ruled on a procedural fairness issue involving the National Energy Board ("NEB") decision to approve the M&NP Project.

1. FACTS

M&NP applied to the NEB for authorization to construct and operate a gas transmission system running through Nova Scotia and New Brunswick. Concurrent applications were made by the Sable Offshore Energy Project ("SOEP") to the NEB, the Canada-Nova Scotia Offshore Petroleum Board, and to the Nova Scotia Energy and Mineral Resource Conservation Board pursuant to their respective jurisdictions. The NEB referred the SOEP and M&NP applications to the federal Minister of Environment for an environmental assessment. By agreement among each of the foregoing regulators, a "Joint Review Panel" was convened to conduct a hearing, and to report on the environmental and socio-economic effects of the SOEP and M&NP applications. Following a lengthy hearing, the Joint Review Panel issued its report (the "Joint Review Panel Report"). UNSI was not a party to the Joint Review Panel's proceeding.

The NEB found that the M&NP application was in the public interest provided that the proponent met a number of specified conditions identified in the Joint Review Panel Report. The NEB subsequently issued a Certificate of Public Convenience and Necessity

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[153] *Coalition of Citizens Impacted by the Shell Plant* v. *Alberta (Energy and Utilities Board)* (1996), 41 Alta. L.R. (3d) 374 (C.A.) at 380 where Justice O'Leary (Hunt J.A. concurring) states that the EUB is "a specialized and expert tribunal charged with administration of a comprehensive set of legislation regulating all aspects of the energy industry in the Province of Alberta."

[154] R.S.C. 1985, c. F-7.

containing these same conditions. Condition 22 provided that "[t]he Company shall submit to the Board a written protocol or agreement spelling out Proponent-Aboriginal roles and responsibilities for cooperation in studies and monitoring." M&NP and UNSI subsequently had a number of meetings. M&NP provided to UNSI a protocol of proponent-Aboriginal roles and responsibilities ("Protocol") which it proposed to submit to the NEB, and a draft agreement in principle pertaining to condition 22. Discussions between the parties did not produce anything more definitive.

On August 24, 1998 M&NP submitted the Protocol and requested that it be accepted in satisfaction of condition 22. This submission was not copied to UNSI. The NEB responded on September 2, 1998 by advising that it considered the August 24th submission as an update and not sufficient to fulfil condition 22. On September 3, 1998 the NEB advised UNSI that it expected correspondence from the parties by the end of September providing an update. This correspondence was copied to M&NP. On September 11, 1998 UNSI wrote to the NEB addressing a number of issues, including condition 22. On September 30, 1998 M&NP wrote the NEB advising that (i) the parties were at an impasse, (ii) they were prepared to abide by the Protocol previously submitted whether or not a comprehensive agreement was be executed, and (iii) the requirements of condition 22 had been addressed. M&NP attached the draft agreement in principle to its September 30th submission but did not copy it to the applicants. The NEB subsequently issued a decision advising that M&NP had satisfied condition 22.

a. *Union of Nova Scotia Indians* v. *Maritimes and Northeast Pipeline Management Ltd.*[155]

In the *M&NP (No. 1)* case UNSI sought an order deeming its existing judicial review application to be, in addition to a judicial review application, an application for leave to appeal pursuant to s. 22 of the *National Energy Board Act*,[156] and consolidating those two applications. Alternatively, UNSI sought an extension of time to file a leave to appeal application. M&NP brought a cross-motion alleging that consolidation of a judicial review application and an application for leave to appeal was improper under s. 18.5 of the *Federal Court Act*. That section reads as follows:

> Notwithstanding sections 18 and 18.1, where provision is expressly made by an Act of Parliament for an appeal as such to the Court ... from a decision or order of a federal board, commission or other tribunal made by or in the course of proceedings before that board, commission or tribunal, that decision or order is not, to the extent that it may be so appealed, subject to review or to be restrained, prohibited, removed, set aside or otherwise dealt with, except in accordance with that Act.

Justice Noël accepted UNSI's argument that because it was not a party before the NEB (*i.e.*, Joint Review Panel) proceedings it had no right of appeal under the *NEB Act*. He found that s. 18.5 must be read in conjunction with s. 28(1) of the *Federal Court Act* which expressly empowers the Federal Court of Appeal to hear and determine judicial

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155 (1999), 243 N.R. 205 (F.C.A.) [hereinafter *M&NP (No. 1)*]; leave to appeal dismissed [1999] S.C.C.A. No. 215 (S.C.C.), online: QL (SCCA).

156 R.S.C. 1985, c. N-7 [hereinafter *NEB Act*].

review applications relating to the NEB, as had been previously held by that court.[157] Consequently, s. 18.5 was held to not be a bar to a judicial review application because of possible appeal.[158]

In the result, UNSI was directed to proceed with its judicial review application and M&NP's cross-motion was dismissed. M&NP's subsequent application for leave to appeal to the Supreme Court of Canada was dismissed without reasons.

b. *Union of Nova Scotia Indians* v. *Maritimes and Northeast Pipeline Management Ltd.*[159]

M&NP (No. 2) concerned the merits of UNSI's judicial review application. The sole issue before the Court was "whether the [NEB] breached rules of procedural fairness when it determined that the respondents had satisfied a condition [22]."[160]

Justice Rothstein commenced his analysis by agreeing with counsel for both parties that the question to be answered was whether "the tribunal on the facts of the particular case act fairly toward the person claiming to be aggrieved?"[161] Having regard to M&NP's obligations under condition 22, the Court found:

> We think it is obvious that the Joint Public Review Panel expected that the protocol or agreement would result from the discussions between the applicants and respondents. Put another way, an agreement is, by definition, a mutually agreeable set of terms between parties. While a protocol is not necessarily mutually agreed to, in the context here, it was expected to be derived from discussions and consultations between the applicants and respondents.
>
> *Having regard to this background, it was implicit in Condition 22 that the National Energy Board would hear from both sides as to what the Condition required.*[162]

The Court also found that, while the NEB had UNSI's September 11th submission which addressed condition 22, it did not have the benefit of UNSI's response to M&NP's September 30th submission. Nor did UNSI have the opportunity to know exactly what M&NP was proposing in order to comply with condition 22.[163]

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157 *Telecommunications Workers Union* v. *Canada (C.R.T.C.)*, [1993] 1 F.C. 231 (C.A.).

158 *M&NP (No. 1)*, *supra* note 155 at 209-10. In contrast, see *Rocky Mountain Ecosystem Coalition* v. *Canada (N.E.B.)*, [1999] F.C.J. No. 1223 (T.D.), online: QL (FCJ), in which an application by the Rocky Mountain Ecosystem Coalition ("RMEC") for judicial review of an NEB decision was denied on the basis of s. 28 of the *Federal Court Act*. In that case the RMEC was indeed a party to the NEB proceedings it sought to impugn and the Court struck its motion. A second RMEC application, considered in the same decision, seeking mandamus requiring the DFO and the Prairie Farm Rehabilitation Administration to fulfill duties as "responsible authorities" under the *CEAA*. The Court struck out RMEC's second motion as well.

159 (1999), 249 N.R. 76 (F.C.A.) [hereinafter *M&NP (No. 2)*].

160 *Ibid.* at 77-78.

161 *Ibid.* at 80, citing *Martineau* v. *Matsqui Institution*, [1980] 1 S.C.R. 602 at 631.

162 *M&NP (No. 2)*, *ibid.* [emphasis added].

163 *Ibid.* at 81.

The Court concluded that

> [i]n the unique circumstances of this case, before issuing a decision that the respondents had satisfied Condition 22, we think the [NEB] was obliged to ensure that [UNSI] had an opportunity to know specifically what [M&NP] were submitting with respect to Condition 22 and to provide [UNSI] with an opportunity to respond to it. In dealing with [M&NP] and [UNSI] separately, with neither knowing precisely what the other was submitting to it, the [NEB] fell into error. The [NEB] did invite comments from [UNSI]. However, the procedure it followed did not ensure that [UNSI], in making these comments, knew the material that the [NEB] would be considering as having satisfied Condition 22. In proceeding in this fashion, the [NEB] breached the rules of procedural fairness.[164]

In addition, because it was not inevitable that the NEB would have reached precisely the same conclusion if UNSI had been afforded procedural fairness, the NEB's decision was invalid.[165]

In the result, the Court remitted the matter back to the NEB for redetermination of whether condition 22 had been satisfied, after hearing UNSI's position on M&NP's September 30th submission and giving M&NP an opportunity to respond.

The NEB convened two written proceedings, one to establish a procedure and a second to consider the effect of the *M&NP (No. 2)* case on mainline start up and operation, respecting condition 22. The NEB eventually determined that condition 22 had been satisfied.

C. *GIANT GROSMONT PETROLEUMS LTD.* v. *ALBERTA (ENERGY AND UTILITIES BOARD)*[166]

The genesis of this case is the application by Gulf Canada Resources Limited ("Gulf") seeking an order of the Alberta Energy and Utilities Board ("EUB") shutting in 183 gas wells in and around Gulf's Surmont area oil sands leases. Certain producers in the area ("Surmont Producers Group") held gas leases overlaying Gulf's in-situ oil sands (bitumen) leases. The dispute before the EUB centred on whether gas production jeopardized bitumen production. As the first step in considering Gulf's application, the EUB held an inquiry in 1997 into whether production of gas in association with bitumen could be detrimental to the ability to recover bitumen. The EUB issued its Inquiry Report,[167] followed by an interim directive and two regulations relating to "concurrent production" of gas found in association with bitumen. The Surmont Producers Group and others brought an application for judicial review claiming the EUB lacked jurisdiction to issue the regulations.

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164 *Ibid.*

165 *Ibid.* at 82.

166 (17 September 1999), Calgary No. 9901-10744 (Alta. Q.B.) [hereinafter *Surmont*].

167 *Gas/Bitumen Production in Oil Sands Area* (25 March 1998), Inquiry Report (E.U.B.).

1. FACTS

Prior to 1983 ss. 26(1)(f) and 29(2) of the *Oil and Gas Conservation Act*[168] required a gas producer to obtain EUB approval to produce gas within or adjacent to an oil sands lease. Those provisions were repealed by the *Oil Sands Conservation Act*[169] notwithstanding that similar provisions were not found in that *Act*. The EUB subsequently amended the *Oil Sands Conservation Regulations*[170] and the *Oil and Gas Conservation Regulations*.[171] The amendments to the *Oil Sands Conservation Regulations* provide as follows:

> **[EUB] approvals required**
>
> 3(3) No person shall produce gas from a well completed in the oil sands strata prior to obtaining an approval from the [EUB], unless the [EUB] has exempted the well from the application of this subsection.
>
> (4) An application to produce gas in accordance with subsection (3) must be made by the well licensee and include the documentation required by the [EUB].
>
> (5) Where it appears to the [EUB] that the ultimate recovery of crude bitumen in the oil sands strata may be affected by gas production, the [EUB] may, on its own initiative or on application by an affected party, make any order or directive it considers necessary to effect the conservation of the crude bitumen in any particular case.

The judicial review application challenged the regulations on the basis that the governing legislation, having been amended in 1983 no longer delegated to the EUB the requisite jurisdiction to issue the amending regulations.

2. DECISION

Justice Hart, in oral reasons, upheld the EUB decision. He framed the issue as, "[w]ere the regulations lawfully and properly made pursuant to the Board's regulation-making power to prevent waste and conserve energy, or are they *ultra vires* as urged by the [Surmont Producers Group]?"[172] His analysis began with a reminder that interpretation of an administrative tribunal's enabling statutes must give effect to the objects and purposes of the legislation,[173] and that the Alberta Court of Appeal has previously found that the EUB is a "specialized and expert tribunal."[174] Justice Hart concluded that

> [i]t is clear from the objects and stated purposes of the legislation that prevention of waste and conservation of resources go to the very root of the Board's purpose and existence. Section 21 of the *Oil Sands Conservation Act* and Section 10 of the *Oil and Gas Conservation Act* expressly empower the Board to pass regulations for these purposes.

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168 R.S.A. 1980, c. O-5.
169 S.A. 1983, c. O-5.5.
170 Alta. Reg. 76/88.
171 Alta. Reg. 151/71.
172 *Surmont*, *supra* note 166 at 1-2.
173 See *Bell Canada* v. *Canada (C.R.T.C.)* (1989), 60 D.L.R. (4th) 682 at 706-707 (S.C.C.).
174 *Coalition of Citizens Impacted by the Caroline Shell Plant* v. *Alberta (Energy and Utilities Board)* (1996), 41 Alta. L.R. (3d) 374 (C.A.).

> In my view, regulations 47/99 and 48/99 are just such regulations. To construe the legislation otherwise would be to "sterilize these powers through over technical interpretations of enabling statutes," to borrow again from the language of Justice Gonthier in *Bell Canada*.[175]

An appeal of Justice Hart's decision is scheduled to be heard in September 2000.

In addition to the above case, the EUB, prior to hearing Gulf's shut-in application on its merits, ruled that it had jurisdiction to consider the matter. The Surmont Producers Group obtained leave to appeal the EUB's determination of its jurisdiction, which leave was stayed until after the EUB ruled on the merits of the Gulf application. In April 2000, the EUB issued Decision No. 2000-22 allowing Gulf's application and ordering the shut-in of 146 gas wells.[176]

D. *CALGARY NORTH H2S ACTION COMMITTEE* V. *ALBERTA (ENERGY AND UTILITIES BOARD)*[177]

The Calgary North H2S Action Committee ("Committee") and the Calgary Regional Health Authority ("CRHA") sought to appeal EUB Decision No. 99-16[178] approving an application by Canadian 88 Energy Corp. ("Canadian 88") for a licence to drill a level 4 critical sour gas well to be located just north of Calgary.

1. FACTS

The EUB stated that it was prepared to approve Canadian 88's application subject to conditions, including

> 1. [Canadian 88] shall develop documented management processes, including policies and procedures for equipment design, specification, procurement, construction, and operations for drilling, completing and testing the well. An assessment of the effectiveness of the management processes shall be audited and endorsed by a suitably qualified third party before submission to the EUB.
>
> ...
>
> 10. [Canadian 88] shall demonstrate and implement immediate ignition within one minute of the ignition criteria being met.
>
> ...
>
> 12. [Canadian 88] and the [Municipal District of Rocky View No. 44 ("MD")] shall identify sensitive individuals within the additional four-km awareness zone. Additionally, [Canadian 88] shall

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175 *Surmont*, *supra* note 166 at 7-8.

176 *Gulf Resources Canada Limited Request for the Shut-In of Associated Gas Surmont Area* (30 March 2000), Decision 2000-22 (E.U.B.).

177 [1999] A.J. No. 1284 (C.A.) online: QL (AJ) [hereinafter *Canadian 88*].

178 *Canadian 88 Energy Corp. Application to Drill a Level 4 Critical Sour Gas Well Lochend Field* (7 July 1999), Decision 99-16 (E.U.B.) [hereinafter *Decision 99-16*].

update its [Emergency Response Plan ("ERP")] to include procedures to notify those designated as sensitive at a level 2 emergency and provide the option to evacuate...

13. [Canadian 88] will satisfy the Board that all individuals involved in implementing the ERP are familiar with the program and capable of implementing it as required. [Canadian 88] shall alert the public included in the ERP on the progress of drilling each week until drilling and testing is complete.

...

16. [Canadian 88] shall satisfy the [EUB] that adequate municipal and provincial resources would be available to assist the MD for protection of the public within its area of jurisdiction. The [EUB] must be satisfied that the MD is prepared to respond regardless of the type of emergency. The [EUB] expects a written agreement between [Canadian 88] and the MD to be finalized and submitted to the [EUB] prior to drilling.

17. [Canadian 88] shall review details of the ERP and update all information including resident information, mapping, emergency contacts, and resources and submit the final plan to the [EUB] for review and approval prior to drilling.

18. [Canadian 88] shall work with all affected emergency planning organizations to prepare contingency plans in the event of an emergency.[179]

The Committee and CRHA applied for leave to appeal claiming that the EUB erred in law and jurisdiction on the following grounds:

(1) conditions 10, 16, and 18 are contradictory and ambiguous;

(2) the EUB improperly delegated its authority under conditions 1, 12, 16, and 18;

(3) the EUB failed to give due considerations to the CRHA's health and safety considerations;

(4) the EUB failed to give adequate reasons; and

(5) the effect of conditions 1, 10, 12, 13, 16, 17, and 18 was to deny interveners their right to a hearing.

2. DECISION

Justice Hunt, on the leave-to-appeal application, held as follows:

(1) Condition 10 was not ambiguous. Further, the "ambiguities" in conditions 16 and 18 "are more apparent than real, when the conditions are read in the light of the

[179] *Canadian 88*, *supra* note 177 at paras. 9, 12 and 21.

Decision itself." In any event, the Court noted that parties could seek clarification from the EUB.[180]

(2) No issue of improper delegation was raised by conditions 1, 12, 16, and 18. "The Decision makes it clear that, while Canadian 88 is required to involve other parties (such as the Municipal District) in some of its activities, the [EUB] itself will rule on the adequacy of Canadian 88's efforts."[181]

(3) Notwithstanding the CRHA's own legislative mandate to promote and protect the health of the population in its region pursuant to the *Regional Health Authorities Act*,[182] the EUB need not give special consideration to the CRHA's submissions over and above other intervenors.[183]

(4) The written reasons contained in *Decision 99-16* were held to be wholly adequate. "The [EUB] carefully assessed the competing views put before it and explained why, in relation to critical matters, it reached its conclusions."[184]

(5) Based on a review of *Decision 99-16*, many of the subject conditions resulted directly from concerns raised by the applicants. No serious issue of law or jurisdiction (the test on a leave-to-appeal application) was raised by the EUB requiring Canadian 88 to satisfy those conditions as conditions precedent to proceeding with its project. Justice Hunt also noted that s. 42 of the *Energy Resources Conservation Act*[185] allowed the EUB to review its decision if any such conditions were not met by Canadian 88.[186]

In the result, leave to appeal was denied on all grounds.

E. *BEAU CANADA EXPLORATION LTD. V. ALBERTA (ENERGY AND UTILITIES BOARD)*[187]

This Alberta Court of Appeal decision deals with the EUB's jurisdiction to recalculate gas allowable orders in circumstances where new evidence discloses a previous breach of the *Oil and Gas Conservation Regulations*.[188]

1. FACTS

APL Oil & Gas Ltd. ("APL") drilled the 12-22 well in an off-target location. The EUB assessed an off-target penalty to the 12-22 well. APL conducted a pressure test on the

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180 *Ibid.* at paras. 10 and 11.
181 *Ibid.* at para. 13.
182 S.A. 1994, c. R-9.07, ss. 5(a)(i) and (b).
183 *Canadian 88*, *supra* note 177 at paras. 17 and 18.
184 *Ibid.* at para. 20.
185 R.S.A. 1980, c. E-11.
186 *Canadian 88*, *supra* note 177 at paras. 24 and 25.
187 [2000] A.J. No. 507 (C.A.), online: QL (AJ) [hereinafter *Beau*].
188 *Supra* note 171.

12-22 well in June 1996 but did not submit the results of that test to the EUB contrary to s. 11.120 of the *Oil and Gas Conservation Regulations* which requires a well licensee to "supply to the [EUB] without delay the data and results of ... flowing or static pressure measurements, pressure build-up, fall-off and drawdown tests." Beau Canada Exploration Ltd. ("Beau") subsequently purchased the shares of APL and hence the 12-22 well in 1998. APL and then Beau continued to produce the 12-22 well at rates set pursuant to EUB issued gas allowable orders for 1997, 1998, and 1999 which were based on the EUB's assumed 5 percent decline rate.

Northstar Energy Corp. and Rustum Petroleums (1993) Limited (collectively "Northstar") had interests in two wells producing from the same pool as the 12-22 well and owned mineral rights in section 21, immediately west of the 12-22 well. In October 1999, Northstar filed an application with the EUB seeking an order shutting in the 12-22 well on the basis that pool production had been inequitable. Beau responded with an application for off-target relief. At that time Beau also submitted to the EUB the June 1996 pressure test taken by APL.

The EUB heard the Northstar and Beau applications together and issued Decision 99-21 granting Beau's off-target penalty relief and purporting to shut in the 12-22 well, not because of inequitable production but because APL had breached the EUB's regulations. In that decision, the EUB stated that it was "committed to ensuring that no operator gains a competitive advantage through failing to comply with its Regulations and considers failure to submit required data (in this case a well test) to be a serious breach of those Regulations."[189] The EUB concluded that it was "appropriate in such circumstances to correct a previous calculation. The 1999 allowable should therefore be adjusted to reflect cumulative overproduction resulting from the steeper pressure decline trend confirmed by the June 1996 test."[190] The EUB ordered the 12-22 well shut in until such overproduction was retired. Beau was granted leave to appeal that portion of *Decision 99-21* ordering shut-in of the 12-22 well.

2. DECISION

Justice Hunt (Fruman and Wittman JJ.A. concurring) addressed whether the EUB had the jurisdiction to (i) recalculate the annual allowables, and (ii) shut in the 12-22 well for breach of a regulation.

On the first issue, starting from the proposition that "[a] fundamental principle of statutory interpretation is that retrospective power can only be granted through clear legislative language,"[191] Justice Hunt found that the term "overproduction," as it is used s. 10 of the *Oil and Gas Conservation Regulations*, is prospective in nature:[192]

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189 *Northstar Energy Corp. and Beau Canada Exploration Ltd. Applications No. 1030981 and 1033083* (29 September 1999), Decision E99-21 (E.U.B.) at 8 [hereinafter *Decision 99-21*].

190 *Ibid.*

191 *Beau, supra* note 187 at para. 28.

192 *Ibid.* at paras. 33, 34, and 37-39.

> The unfairness of any other interpretation is apparent when one considers the significant penalty factor authorized by subsection [10.280(1)] and applied in this case. Were the [EUB] able to recalculate allowables after the gas had been produced, a producer could be penalized heavily despite having produced in compliance with an earlier order. Given the changing price of commodities such as natural gas and the various costs associated with production, such a retroactive order could have grave financial consequences for a producer. The statutory language would have to be much clearer to accomplish this result.[193]

With respect to the second issue (whether the EUB had the jurisdiction to shut in the 12-22 well for breach of a regulation), Justice Hunt considered the scope s. 19(a.1) of the *Oil and Gas Conservation Act.*[194] That section provides as follows:

> 19 The Board may...
>
> (a.1) shut in the well for a definite period of time or indefinitely if it is made to appear to the Board that a contravention of this Act, the regulations, or an order of the Board has occurred with respect to the well

Justice Hunt held that the EUB could not purport to shut in the 12-22 well pursuant to s. 19(a.1) in this case for two reasons. First, the EUB's finding that there was no inequitable drainage to Northstar, thus justifying Beau's off-target penalty relief, was largely dispositive of the grounds upon which Northstar's shut-in application was made. Section 19(a.1) did not play a role before the EUB at the hearing.[195] Second, Justice Hunt noted that *Decision 99-21* does not reference s. 19(a.1) and that s. 29(2) of the *Energy Resources Conservation Act*[196] provides that a party whose rights may directly and adversely be affected by a EUB decision must be given "a reasonable opportunity of learning the facts bearing on the application," and "a reasonable opportunity to furnish evidence relevant to the application." Presumably, Beau could have adduced different evidence if it had it been put on notice that the EUB was concerned about APL's breach of s. 11.120 of the *Oil and Gas Conservation Regulations* and was considering a shut in pursuant to s. 19(a.1). Justice Hunt concluded that "[i]n a properly convened and directed proceeding, with appropriate notice and adequate evidence, the [EUB] has jurisdiction to shut in a well for a breach. That was not, however, the purpose or focus of this hearing, nor the case Beau was asked to answer."[197]

In the result, the Court vacated the part of *Decision 99-21* relating to shutting in the 12-22 well and returned the matter to the EUB for further consideration in light of the Court's findings.

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193 *Ibid.* at para. 38.
194 R.S.A. 1980, c. O-5.
195 *Beau, supra* note 187 at paras. 45 and 46.
196 *Supra* note 185.
197 *Beau, supra* note 187 at para. 50.

F. *ALLIANCE GAS MANAGEMENT INC. V. ONTARIO (ENERGY BOARD)*[198]

1. FACTS

Alliance Gas Management Inc., Apollo Gas Inc., and Direct Energy Marketing Limited (collectively "Gas Marketers") were licenced gas marketers operating in Ontario. Gas marketing in Ontario is regulated by the Ontario Energy Board ("OEB") in accordance with Part IV of the *Ontario Energy Board Act, 1999*.[199] Section 44(1)(c) provides that "[t]he Board may make rules ... governing the conduct of persons holding a licence issued under Part IV." Pursuant to that provision, the OEB has issued its *Code of Conduct for Gas Marketers*.[200] Sections 2.6 and 2.7 of the *Code of Conduct* prescribe certain conditions that comprise part of a gas marketer's licence relating to the gas marketer's customer contracts. Sections 50(3) and 53(6) of the *OEB Act* respectively provide that the director and the OEB "may not impose any condition that is not authorized by regulation."

The Gas Marketers commenced an action challenging the OEB's jurisdiction to issue ss. 2.6 and 2.7 of the *Code of Conduct* insofar as those provisions are restricted by operation of ss. 50(3) and 53(6) of the *OEB Act* and purport to control the contractual relationships of gas marketers and business practices.

2. DECISION

Justice Lane delivered an oral judgment for the Ontario Divisional Court finding that to construe the OEB's regulation-making power under s. 44(1)(c) of the *OEB Act* as being somehow restricted by ss. 50(3) and 53(6) would be to render it meaningless.[201] Further, the OEB's power to regulate gas marketers must include the power to regulate the business practices in the *OEB Act* and, the term "conduct," as it is used in s. 44(1)(c), is broad enough to encompass the types of requirements contemplated in ss. 2.6 and 2.7 of the *Code of Conduct*. In the result, the matter was dismissed.

VIII. CREDITORS' RIGHTS

A. *RE SMOKY RIVER COAL LTD.*[202] — LIEN PRIORITIES ON MINERAL LEASES

This case is the first of two Smoky River Coal Ltd. decisions dealing with priorities of builders' liens. It considered competing priorities of liens under the *Builders' Lien Act*,[203] the *Bank Act*,[204] and security interests pursuant to a trust deed and mortgage, all registered against coal leases held by Smoky River Coal Ltd. ("Smoky"). In his decision, Justice LoVecchio held that builders' liens filed with both the Land Titles Office

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198 (1999), 128 O.A.C. 365 (Div. Ct.) [hereinafter *Alliance Gas*].

199 S.O. 1998, c. 15 [hereinafter the *OEB Act*].

200 Ontario Energy Board, *Code of Conduct for Gas Marketers*, 2 March 1999 [hereinafter *Code of Conduct*].

201 *Alliance Gas*, *supra* note 198 at 366.

202 (1999), 238 A.R. 158 (Q.B.) [hereinafter *Smoky River Coal* — Lien Priorities on Mineral Leases].

203 R.S.A. 1980, c. B-12.

204 S.C. 1991, c. 46.

and the Department of Energy were subordinate to a mortgage filed at the Department of Energy. In so doing, he did not follow the Saskatchewan Court of Appeal decision in *Canada Trust Co.* v. *Cenex Ltd.*[205]

1. FACTS

On October 31, 1996 Smoky obtained a loan of $75 million US from a group of lenders ("Petitioners"). The loan was secured by a deed of trust and mortgage, which was registered at the Department of Energy on November 4, 1996, charging the coal leases. All funds were advanced prior to the registration of liens by the lienholders at both the Department of Energy and the Land Titles Office.

Smoky had also obtained financing from the CIBC, which was secured by a registered deed of trust and mortgage, and by a demand debenture which charged the coal leases. The priority of the CIBC's security was not in issue in this application as all parties admitted it.

2. DECISION

In reviewing the priorities, the Court held that the mortgagee's failure to register the mortgages with the Land Titles Office did not make them invalid, notwithstanding s. 9(2) of the *Builders' Lien Act* which referred to "prior registered mortgages." This is because while the definition of "encumbrance" in the *Land Titles Act*[206] included both builders' liens and mortgages, s. 194 of the *Land Titles Act* specifically prohibited the registration of "encumbrances" against mineral interests owned by the Crown.

In contrast, s. 26.1 of the *Builders' Lien Act* specifically states that when a lien attaches to an interest granted by the Crown, and the interest is "less than a fee simple estate, and ... is not registered under the Land Titles Act, the statement of lien shall be registered with the Minister of Energy." Justice LoVecchio held that since neither liens nor mortgages could be registered under the land titles system, and liens were to be registered with the Department of Energy, registration of the mortgage at the Department of Energy was sufficient to meet the registration requirement of s. 9(2) of the *Builders' Lien Act*.[207]

Justice LoVecchio also held that the liens registered after the funds were advanced under the Petitioners' credit facility were subordinate to the Petitioners' registered mortgages. This was as a result of ss. 140(4) and (5) of the *Mines and Minerals Act*,[208] which provide for a "first to register" approach to priorities, subject to the priority scheme in the *Builders' Lien Act*. The *Builders' Lien Act*, in turn, provides that liens attach to "all estates and interests in the mineral concerned,"[209] and have priority over all attachments

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205 [1982] 2 W.W.R. 361 [hereinafter *Cenex Appeal*].
206 R.S.A. 1980, c. L-5, s. 1(f).
207 *Smoky River Coal* — Lien Priorities on Mineral Leases, *supra* note 202 at 163.
208 R.S.A. 1980, c. M-15.
209 *Builders' Lien Act*, *supra* note 203, s. 4(2).

but that "a registered mortgage or a mortgage registered by way of caveat has priority over a lien to the extent of the mortgage money in good faith secured or advanced in money prior to the registration of the statement of lien."[210] It also holds that "advances or payments made under a mortgage after a statement of lien has been registered rank after the lien."[211]

In reaching his conclusion regarding priorities, Justice LoVecchio also examined whether the lien could be considered a "super lien" pursuant to reasoning in the *Cenex Appeal* which permitted the attachment of a lien to a security interest held in respect of minerals by interpreting the words "all estates and interests" to include such security interests. As with the Saskatchewan legislation considered in the *Cenex Appeal*, this interpretation could be consistent with s. 4(2) of the Alberta *Builders' Lien Act*. However, Justice LoVecchio rejected this position by finding that the purpose and effect of s. 4(2) was to eliminate the requirement of consent by all parties with *ownership interests* in the asset to the work done by lien claimants, in order to encumber the interest. Therefore, the words "all estates and interests" in s. 4(2) of the *Builders' Lien Act* should be read as limited to ownership interests but not to security interests.

This case may have been the first in Alberta to consider the relative priorities of builders' liens filed against mineral interest and a mortgage. In so doing, it did not follow the Saskatchewan case of *Cenex Appeal*. This case also indicates that only funds advanced under a registered mortgage prior to the filing of the liens will take priority.

B. *RE SMOKY RIVER COAL LTD.*[212] — LIEN PRIORITIES ON SURFACE LEASES

This is the second of the two Smoky River Coal Ltd. decisions dealing with priorities of builders' liens. This decision analyzes priorities with respect to Smoky's surface leases and the mining facilities, rather than with Smoky's coal mineral leases.

1. FACTS

In addition to the coal leases which were the subject of the first Smoky decision, Smoky also held several surface lease interests and a mining facility interest. The majority of the facility and leases were on unpatented lands but a certificate of title had been issued in respect of a half section of the mine site which contained an important portion of the mine facility. The group of United States lenders ("Petitioners") who held security interests created by a deed of trust and mortgage, applied to the Court for priority with respect to certain lien holders ("Lienholders") for the surface leases. For further discussion of the facts of this case, please see the previous case.[213]

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[210] *Ibid.*, s. 9(2).

[211] *Ibid.*, s. 9(3).

[212] (1999), 71 Alta. L.R. (3d) 22 (Q.B.) [hereinafter *Smoky River Coal* — Lien Priorities on Surface Leases].

[213] *Smoky River Coal* — Lien Priorities on Mineral Leases, *supra* note 202 and accompanying text.

2. DECISION

Justice LoVecchio of the Alberta Court of Queen's Bench resolved five issues in this decision. These issues were as follows:

(1) Did the work done by the Lienholders entitle them to builders' liens against the surface leases as well as the mineral interests?

(2) Was the mine site sufficiently integrated so that all Lienholders could claim against the whole mine site, and that those with claims arising from the untitled land could claim against the titled land, and vice versa?

(3) Did the prior registration by the Lienholders of their liens at the Land Titles Office give them a priority over the security interest of the Petitioners' trust deed, which was registered at the Alberta Personal Property Registry ("PPR") and the Department of Energy, but not at the Land Titles Office?

(4) Did the prior registration by the Lienholders of their lien against unpatented land on the Land Titles Office unpatented register give them priority over the security interest of the Petitioners' trust deed registered at the PPR and the Department of Energy, but not at the Land Titles Office?

(5) If the answer to issues 1 to 3 was yes, and to issue 4, was no, was the integrated nature of the mine site sufficient to permit the priority arising from the Land Titles Office registration for the patented lands, sufficient to grant priority to the liens registered against the unpatented lands?[214]

In the first issue, Justice LoVecchio asked whether the Lienholders at the mine site were entitled to a lien only on the mineral interests, or also on the surface leases. In resolving this issue, he examined s. 4 of the *Builders' Lien Act*, which states that a lien may arise in respect of work done to recover a mineral interest and held that this section permitted the existence of a lien on the mineral interests but did not exclude a lien on the surface interests. Therefore, "an interest in a surface lease is to be considered distinct from the mineral interest and it may be attached by a lien arising from work the object of which is the recovery of the mineral."[215]

The second issue arose as a result of the fact that some of the Lienholders did not work the entire mine site. To resolve this, Justice LoVecchio relied on the fact that the improvements, while on different parcels of land than that for which the lien was claimed, were not "several independent improvements."[216] He found that they were "an integrated operation in which work done on specific areas of the mine site was performed for the common purpose of improving the mine site as a whole."[217]

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214 *Smoky River Coal* — Lien Priorities on Surface Leases, *supra* note 212 at 25.

215 *Ibid.* at 31.

216 *Ibid.* at 33.

217 *Ibid.*

Justice LoVecchio described the mine site as follows:

> [The] mine and mine site is an integrated operation in which no part exists purely for its own sake. The operation exists as a whole and work done in one section of it is necessarily done to improve the effectiveness of the whole operation ... Can it really be said, for instance, that a road through the mine site to a facility on a different part of the mine site did not improve that facility such that the corresponding Builders' Lien should be limited to the land under the road.[218]

In addressing issues 3 and 4, Justice LoVecchio considered the priorities between the Petitioners and the Lienholders pursuant to the *Builders' Lien Act* and to the *Land Titles Act.* He found that in this case, as the Lienholders had a prior registration at the Land Titles Office, they were entitled to priority. This was a result of ss. 9(2) and 26(4) of the *Builders' Lien Act.* Section 9(2) states that a "registered mortgage or mortgage registered by way of a caveat has priority over a lien to the extent of the mortgage money in good faith secured or advanced in money prior to the registration of the statement of lien." Section 26(4) states that liens shall be registered at Land Titles "as an encumbrance against the estate or interest in the land affected; or if the land affected has not been registered under the *Land Titles Act* ... [the Registrar] shall make a record of the lien in a book or in any other manner he considers advisable."

Also relevant was s. 59.2 of the *Law of Property Act*,[219] which indicates that "registered" means registered at the PPR but then states, in s. 59.2 (8), that this "section is subject in all respects to the *Land Titles Act* and the *Mines and Minerals Act*, and the priority of any interest registered or filed under either Act shall be determined pursuant to that Act."

Based on the above, Justice LoVecchio held that the party which registers first under the land titles system will obtain priority regardless of whether there had been an earlier registration by another party at the PPR. This is true even if, as in this case, the mineral title is carved out of the surface interests and the surface leases were not even registered at the Land Titles Office. The fact that the surface leases could be registered at the Land Titles Office was sufficient, as the liens could be considered preregistered against those leases.

In arriving at this conclusion, Justice LoVecchio's approach to priorities was consistent with that of the Saskatchewan Court of Queen's Bench in *Canada Trust Co.* v. *Cenex Ltd.*[220] The *Cenex Trial*, which was reversed on appeal on different grounds, held that with respect to the unpatented lands at issue in that case, a debenture, which could not be registered at Land Titles as the lands were unpatented, should continue to have priority. However, Justice LoVecchio distinguished *Cenex Trial* on the ground that the lands were the subject of a certificate of title.

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218 *Ibid.*

219 R.S.A. 1980, c. L-8, s. 59.2(1)(d).

220 (1980), 116 D.L.R. (3d) 731 (Sask. Q.B.), rev'd on other grounds (1982), 131 D.L.R. (3d) 479 (C.A.) [hereinafter *Cenex Trial*].

With regard to the unpatented lands under consideration in issue 4, Justice LoVecchio held that the prior registration of the liens on the non-patent sheets at the Land Titles Office did not accord priority to the Lienholders. This is a result of the operation of s. 26.1 of the *Builders' Lien Act*, which reads:

> 26.1(1) When a lien attached to an estate or interest in minerals held directly from the Crown in right of Alberta and the estate or interest
>
> (a) is less that a fee simple estate, and
>
> (b) is not registered under the Land Titles Act,
>
> the statement of lien shall be registered with the Minister of Energy and not with the Registrar and this Act applies to all claims of lien so registered with the Minister of Energy.

Because the "Registrar" is the Registrar of Land Titles, liens against unpatented Crown mineral lands cannot be registered at the Land Titles Registry. Similarly, s. 194 of the *Land Titles Act* holds that no lease or encumbrances, including liens and mortgages, of Crown minerals are to be registered at Land Titles. Justice LoVecchio contrasted this with s. 26(4) of the *Land Titles Act*, which deals with surface titles, and which requires the Registrar to record liens in a book where the land has not been registered under the *Land Titles Act*. In this case the Registrar recorded these liens on the "non-patent sheets" as no certificate of title existed.

No provision similar to s. 26(4) exists for the registration of other types of security interests against the unpatented lands (surface leases). Justice LoVecchio, in resolving this inconsistency, noted that Alberta oil and gas practice was such that interests against surface leases in unpatented lands are registered at the Department of Energy as these are incidental to mineral interests. Given this, Justice LoVecchio held that the solution most consistent with the statutes and with industry practice was for priority claims against mineral surface leases of unpatented lands to be decided according to the registry of the Department of Energy.

Finally, with respect to issue 5, Justice LoVecchio held that the integrated operation of the mine site did not permit the priority of liens registered at the Land Titles Office against the titled land to extend to the untitled land.

The result of Justice LoVecchio's findings was that the surface rights of the entire mine were subject to attachment; but, although the liens for the titled portion had priority over the Petitioner's trust deed registered at the Department of Energy, by virtue of their registration at the Land Titles Registry, the liens against the untitled portion of the mine site ranked after the trust deed.

This case affirms the Alberta oil and gas industry practice with respect to registration against surface leases and in so doing clarifies an inconsistency in the applicable legislation. It also provides a useful analysis of lien registrations against surface leases at a site with integrated operations.

C. *RE SMOKY RIVER COAL LTD.*[221] — WOODMEN'S LIEN

This case determined the validity of a woodmen's lien registered against property of Smoky by deciding whether an order staying proceedings issued under s. 11 of the *CCAA* suspends the time to file, and whether Smoky was estopped from disputing the validity of the lien.

1. FACTS

Triple G Construction Ltd. ("Triple G") was a contractor who bid for and subsequently entered into three tree clearing and timber salvage contracts with Smoky. The third contract was invoiced on July 15, 1998. Subsequently, the cheque given to Triple G by Smoky as payment for work under this contract was returned. By order of the court dated August 7, 1998, the operations of Smoky became subject to the supervision of the court under the *Companies' Creditors Arrangement Act*,[222] and the order stayed all proceedings. Triple G then filed a lien for the amount of the third contract, indicating that the claim was a secured claim as a result of an entitlement to a lien under the *Woodmen's Lien Act*.[223] Triple G did not give the required notice of its lien, and in fact, more than thirty days had expired by the time it did file its lien. Pursuant to the *Woodmen's Lien Act*, Triple G had only thirty days to file its lien.

2. DECISION

Justice LoVecchio considered whether the right of Triple G to file a lien under the *Woodmen's Lien Act* expired thirty days after the work was completed, and whether Smoky was estopped by its conduct from disputing the validity of Triple G's claim under the lien.

The *CCAA* order which, *inter alia*, stayed all proceedings against Smoky was granted during the thirty-day period that Triple G had to file its lien pursuant to s. 9(1) of the *Woodmen's Lien Act*. In order for Triple G's claim to succeed, Justice LoVecchio had to find that the issuance of the *CCAA* order suspended the running of this thirty-day period.

In his decision, Justice LoVecchio noted a similar situation which may arise under the *Bankruptcy and Insolvency Act*,[224] where a supplier has a right to repossess goods for which it has not been paid and which are delivered thirty days prior to a bankruptcy. Under the *BIA* a bankruptcy may have a retroactive date, for example, the date of filing of the petition, in which case a supplier may find its thirty-day period to have lapsed. For this reason s. 81.1(4) of the *BIA* provides that the period during which an attempt at reorganization is being made will not count as part of the supplier's thirty-day period to repossess goods. The *CCAA* has no similar protection.

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[221] (1999), 246 A.R. 154 [hereinafter *Smoky River Coal* — Woodmen's Lien].
[222] *CCAA*, *supra* note 67.
[223] R.S.A. 1980, c. B-12.
[224] R.S.C. 1985, c. B-3 [hereinafter *BIA*].

Justice LoVecchio noted that this anomaly between the *BIA* and the *CCAA* had been dealt with in *Re Woodward's Ltd*,[225] where a stay order under the *CCAA* prevented suppliers from crystalizing their repossession rights by filing a petition for a receiving order. There, it was decided that in order to preserve the supplier's rights under the *BIA*, the supplier's thirty-day period for repossession was suspended during the period in which the reorganization under the *CCAA* was being pursued.

Woodward's was distinguished by Justice LoVecchio on two grounds. First, the *CCAA* order in *Woodward's* did not affect the computation of the period but only deemed the delivery date to be different. Second, the supplier's rights in *Woodward's* had not expired when the application was made. In the case at bar, Triple G's time under the *Woodmen's Lien Act* had expired by the time Triple G tried to file. Therefore, Justice LoVecchio determined that Triple G's rights had ceased to exist prior to its filing a statement of lien.

Justice LoVecchio further noted that *Woodward's* indicated that "*CCAA* orders are often lifted in order to permit the filing of Builders' liens ... [and that] the Court had in the past given leave *nunc pro tunc* later on when the relevant step was performed within the time required by the statute (in violation of the stay) when it was not practical to have [the stay] lifted first."[226] To now grant Triple G's request would be to put it in a better position than if the stay had never been granted.

Justice LoVecchio also held that Smoky was not estopped from rejecting the validity of the lien, based on general assurances made to Triple G that it would get paid. Furthermore, the fact that the monitor of Smoky had recognised the total amount owed to Triple G pursuant to the claims process under the *CCAA* was not an acceptance of the validity of the security. As there was no unambiguous acceptance of the validity of the lien, there was no acceptance of the lien. Justice LoVecchio further noted that in fact, the lien's validity had been in doubt as between the parties.

In summary, this case highlights the risk to lawyers who act for clients with lien claims in the context of *CCAA* proceedings. A prudent lawyer, where time permits, will attempt to have the stay lifted. However, if the time to file will expire, the judgment contemplates that a lien will be filed and a "*nunc pro tunc*" application made. Lien filing periods are not extended by *CCAA* stay orders. Presumably the reasoning in this case would also apply to the calculation of time to file under the *Builders' Lien Act*.

D. *RE SMOKY RIVER COAL LTD.*[227] — *CCAA* STAY OF ARBITRATION

In yet another Smoky River Coal Ltd. case, the Alberta Court of Appeal considered whether a *CCAA* judge had the jurisdiction to determine whether arbitration pursuant to a shareholders' agreement was a proceeding which could be stayed under the *CCAA*. Justice Hunt held that a judge does have the discretion to stay an arbitration proceeding

[225] (1993), 17 C.B.R. (3d) 253 (B.C.S.C.) [hereinafter *Woodward's*].

[226] *Smoky River Coal* — Woodmen's Lien, *supra* note 221 at 157.

[227] (1999), 237 A.R. 326 (C.A.) [hereinafter *Smoky River Coal* — *CCAA* Stay of Arbitration]. An appeal to the Supreme Court of Canada in this matter has been discontinued.

and to establish a *CCAA* procedure notwithstanding a prior contractual agreement to arbitrate.

1. FACTS

Luscar Ltd. and Consol of Canada Inc. ("Appellants") and Smoky as respondent, were owner/operators of several coal mines. Neptune Bulk Terminals (Canada) Ltd. ("Neptune") owned and operated a Vancouver port facility. Smoky and the Appellants were shareholders of Neptune, and shipped coal through the facility.

Neptune had a shareholders's agreement ("Agreement") which contained restrictions on the transfer of rights. Consequences of a breach of the Agreement included the right of first refusal to purchase, at book value, shares held by the shareholder who breached the Agreement. The Agreement also contained a provision for arbitration in British Columbia pursuant to the British Columbia *Commercial Arbitration Act*.[228]

In April 1998, a dispute arose which the Appellants later alleged constituted a breach by Smoky of its obligations under the Agreement. The Appellants received information in September 1998 which confirmed their belief that a breach had occurred. The breach that Smoky allegedly committed was the transport of six train loads of coal through the terminal, the capacity for which the Appellants alleged had been subcontracted. However, on July 30, 1998, Smoky's lenders had filed a petition under the *CCAA*. An order was granted on August 7, 1998, retroactive to July 31, 1998. This order was extended several times and a monitor had been empowered to oversee Smoky's affairs. The monitor was not empowered to take possession of Smoky's assets or to manage its business.

Smoky had filed an application seeking, *inter alia*, to prohibit arbitration under the Agreement. The Appellants had applied to stay Smoky's motion. The Chambers Judge, Justice LoVecchio,[229] held that, pursuant to s. 15 of the British Columbia *Commercial Arbitration Act*, Smoky's motion should be stayed and the matter sent to British Columbia for arbitration unless the agreement to arbitrate was "void, inoperative or incapable of being performed."[230] In this case, as a result of Smoky's insolvency and the appointment of the monitor, Justice LoVecchio had concluded that the Agreement was incapable of being performed.

2. DECISION

In analyzing whether the Justice LoVecchio had authority under s. 11 of the *CCAA* to order a stay of the British Columbia arbitration proceedings, Justice Hunt held that

[228] R.S.B.C. 1996, c.55.

[229] [1999] A.J. No. 272 (Q.B.), online: QL (AJ).

[230] *Smoky River Coal Ltd. — CCAA* Stay of Arbitration, *supra* note 227 at 330, citing the Chambers decision, *ibid.*

pursuant to s. 11,[231] "proceedings" could include extrajudicial conduct. She also noted that even though arbitration is often considered expeditious, appeals of arbitration awards may lengthen and complicate a decision-making process, impacting the efficacy of *CCAA* proceedings. Justice Hunt then indicated that she considered that the Appellants could be creditors under the *CCAA*, in which case their contractual rights could be affected permanently.[232] She reasoned that a "claim" for purposes of the claims procedures in s. 12 of the *CCAA* was a "debt provable in bankruptcy," as defined in the *BIA*.[233] However, the closest definition in the *BIA* is of a "claim provable in bankruptcy," which she in turn defined as a "contingent and unliquidated claim recoverable by legal processes."[234] Therefore, she held that "debt" and "claim" were interchangeable under the *BIA*, and that the notion of "debt" under the *CCAA* should be treated as broadly as "claim" under the *BIA*. This is because bankruptcy proceedings under the *BIA* tend to be final, and claims to be dealt with must be resolved during bankruptcy proceedings. Under the *CCAA*, however, there is a possibility that if a plan of arrangement is accepted, there will be a future going concern against which a claim may be asserted. Furthermore, in certain cases such as the case at bar, Justice Hunt indicated that it may be difficult to prepare and vote on a plan of arrangement without resolutions of apparently unripe claims.

Justice Hunt then considered whether s. 11 of the *CCAA* authorized the order made in this case even if the Appellants were not creditors for purposes of the *CCAA*. The Appellants had submitted that there was no case law precedent that allowed a court to permanently alter the contractual rights of a non-creditor, which they submitted was beyond the scope of the *CCAA*. Justice Hunt recognized that there was no entirely analogous existing jurisprudence, but that her reading of the existing jurisprudence supported her interpretation of s. 11(4) of the *CCAA*. She noted that the language of s. 11(4) of the *CCAA* was very broad. It allowed the court to make an order "on any such terms as it may impose,"[235] and used expansive words such as "all proceedings," "in any action," and "with any other action." She also stated that her position was consistent with the legislative history of the *CCAA*, which was "intended to provide a means of enabling the insolvent company to remain in business,"[236] and that the legislative history required that the court take account of diverse societal interests. In this context she noted that there had been "a number of cases where third party rights have been affected by a stay order."[237]

Furthermore, Justice Hunt noted that the *CCAA*'s constitutional validity had been upheld, and that "the continuance of insolvent companies must be considered a

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[231] Section 11 reads:

> 11(4) A court may, on an application in respect of a company other than an initial application, *make an order on such terms as it may impose...*
>
> (c) *Prohibiting*, until otherwise ordered by the court, the commencement of or proceedings with *any other action, suit or proceedings* against the company [emphasis added].

[232] *Smoky River Coal — CCAA* Stay of Arbitration, *supra* note 227 at 336.

[233] *Ibid.*

[234] *Ibid.*

[235] *Ibid.* at 339.

[236] *Ibid.*

[237] *Ibid.* at 340.

constitutionally valid statutory objective."[238] As a result, she held that the *CCAA* gave Justice LoVecchio, the Chambers Judge, the discretion to make the Smoky order, which order declared that the Alberta Court of Queen's Bench "has jurisdiction to hear and determine the issue of whether Smoky has been or is in default under the Neptune shareholders' agreement and any and all related issues arising therefrom."[239]

A further review of the case law led Justice Hunt to the conclusion that "a judge has discretion under the *CCAA* to underline issues to be determined in another forum but is under no obligation to do so. The proper exercise of the discretion would be very fact dependent."[240] In this particular case, she noted that Justice LoVecchio had considered a number of matters, and decided that the arbitration would compromise the *CCAA* process, that his order would actually expedite resolution of the dispute, and that an expedited resolution of the dispute was critical to the *CCAA* given its possible impact on the plan of arrangement.

In addition, Justice Hunt noted that in this particular case, there had been no determination of the rules to be used in resolution of the dispute under the procedures to be determined pursuant to the Smoky order. As a result, the Appellants would be able to argue that the corresponding rules of the British Columbia *Commercial Arbitration Act*[241] be used in the *CCAA* proceedings. Therefore, the order under appeal did not permanently affect the substantive contractual rights of the Appellants, but merely the forum in which those rights would be assessed.

Finally, Justice Hunt noted that in the event of a conflict between the *CCAA* and the British Columbia *Commercial Arbitration Act*, a provincial statute, the issue would be decided in favour of the *CCAA*.[242]

E. *RE CHAUVCO RESOURCES INTERNATIONAL LTD. (BANKRUPT)*[243]

In this case, the Alberta Court of Queen's Bench reviewed whether the proceeds of a pending arbitration could be set-off against a claim of a creditor against Chauvco Resources International Ltd. ("Chauvco International"). The creditor, on the basis of its claim, had petitioned Chauvco International into bankruptcy. Justice Forsyth found that the amount pending from arbitration could not stay the bankruptcy petition. He also reviewed whether the Court had jurisdiction to make this particular order, as Chauvco International was incorporated in Bermuda.

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[238] *Ibid.*, citing *CCAA*, *Re Canada (A.G.)* v. *Quebec (A.G.)*, [1934] S.C.R. 659.

[239] *Smoky River Coal — CCAA* Stay of Arbitration, *ibid.* at 338.

[240] *Ibid.* at 342.

[241] *Ibid.*, s. 23 of the *Commercial Arbitration Act* and r. 33 *Domestic Commercial Arbitration Rules of Procedure* (B.C.).

[242] *Smoky River Coal — CCAA* Stay of Arbitration, *ibid.* at 343.

[243] (1999), 239 A.R. 116 (Q.B.), online: QL (AJ) [hereinafter *Chauvco*].

1. FACTS

Services Petrolliers Schlumberger SA ("SPS") and Compagnie des Services Dowell Schlumberger SA ("CSDS") (jointly "Schlumberger") petitioned for Chauvco International to be judged bankrupt and for a receiving order to be made in respect of its property.

Chauvco International was incorporated in Bermuda on July 29, 1997. On December 18, 1997, it acquired several subsidiaries including Chauvco Resources (Gabon) SA ("Chauvco Gabon"). In addition, it held Chauvco Services (Canada) Ltd. ("Chauvco Canada") as a wholly owned subsidiary. Chauvco Canada was an Alberta corporation. The petitioners contended that Chauvco International's business affairs were administered from Chauvco Canada's offices in Calgary.

Schlumberger had contracted with Chauvco Gabon for the provision of services. The work was to be done in two phases. The contract for the second phase was terminated on January 12, 1998, at which point Chauvco International owed Schlumberger $6,000,000 US. Following negotiations, Chauvco International proposed to Schlumberger a 50 percent discount on outstanding invoices which Chauvco International indicated amounted to 15 percent of all amounts billed by Schlumberger to Chauvco International during the project.

Schlumberger refused to compromise and made a formal demand for the outstanding invoices. On June 29, 1998, Chauvco International gave notice that it intended to proceed to arbitration through the International Chamber of Commerce. In requesting arbitration, Chauvco Gabon, for the first time, raised the fact that Schlumberger had negligently damaged a well causing a loss of $5,000,000 US. At the date of the hearing by the Alberta Court of Queen's Bench, the arbitration was scheduled to proceed several months in the future.

2. DECISION

The first matter Justice Forsyth reviewed was whether the Court had the jurisdiction to order Chauvco International into bankruptcy. Chauvco International had argued that s. 43(5) of the *BIA* granted jurisdiction to a court having jurisdiction in the judicial district of the locality of the debtor. "Locality" in turn is defined in s. 2 as "the principal place where the debtor carries on business in the year preceding bankruptcy, resides in the year preceding bankruptcy, or should these tests not apply, where the greater portion of the property of the debtor is situated." On this basis, Chauvco International argued that Calgary was not the principal place where it carried on business, and that jurisdiction did not arise. The petitioners in turn argued that pursuant to s. 43(1) of the *BIA*,[244] the issue of the locality of the debtor could only arise once a person carried on business in Canada.

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[244] *BIA*, *supra* note 224. Section 43 reads:

> 43. (1) Subject to this section, one or more creditors may file in court a petition for a receiving order against a debtor if, and if it is alleged in the petition that,
>
> (a) the debt or debts owing to the petitioning creditor or creditors amount to one thousand dollars; and
>
> (b) the debtor has committed an act of bankruptcy within six months next preceding the filing of the petition.

Justice Forsyth agreed that a petition had to be properly brought under s. 43(1). As s. 43(1) relied on the definition of "debtor" in s. 2(1), which in turn, required the debtor to be resident in or carry on business in Canada, this was a requirement to be met before the petition could be filed. However, Justice Forsyth went on to find that Chauvco International was a debtor for purposes of s. 43(1) of the *BIA*, as it carried on business in its Calgary office. Between incorporation in December of 1997 and the filing of the petition in July 1998, there were four employees of Chauvco International, three of whom resided in Calgary and worked out of the Calgary office. The fourth, who was also the President and Chief Executive Officer of Chauvco International, did not reside in Calgary, but had a rented apartment and car leased for his use when in Calgary on Chauvco International business. While Chauvco International submitted that all three employees were seconded to Chauvco Canada, Justice Forsyth held that Chauvco International's business was being administered and controlled through the Calgary office.

With respect to whether business was conducted out of the office in Gabon, Justice Forsyth noted that there were no Chauvco International employees in the Gabon office but rather only employees of Chauvco Gabon. The Court further noted that no Chauvco International records were kept in Gabon. The fact that the contracts giving rise to the issue were for the development of the oil fields in Gabon where production and generation of income took place, was not sufficient to indicate that the principal place where Chauvco International carried on business was Gabon. Therefore, Justice Forsyth held that if s. 43(5) of the *BIA* was necessary to establish the jurisdiction of Canadian courts, Calgary was the principal place where Chauvco International carried on business. Section 43(5) held that a petition for bankruptcy should be filed in the locality of a debtor's principal place of business. Therefore, Judge Forsyth had jurisdiction to hear the petition.

Justice Forsyth then reviewed whether the requirements of s. 43(1) of the *BIA* had been met. He had already found that Chauvco International was a debtor, and s. 43(1) further required that the debt owing must amount to $1000, and that the debtor must have committed an act of bankruptcy within six months preceding the filing of the petition. In respect of the requirement that the debt amount to $1000, Justice Forsyth found that while there was some evidence as to the dispute of the amounts, prior correspondence between the parties had clearly indicated that Chauvco International had accepted that it had an obligation to Schlumberger. Indeed, Chauvco International's letter proposing a 50 percent reduction of the invoiced amount to Schlumberger contained no mention of a breach of contract or negligence, and in fact stated that if such a proposal would be accepted, Chauvco International would be prepared to give Schlumberger a right of first refusal for the provision of other services. As nothing indicated that the dispute over the correct amount of the invoices was for the entire amount invoiced, which totalled over $6,000,000 US, the Court accepted that Schlumberger as petitioners had clearly demonstrated that a debt of at least $1000 existed.

In this case Justice Forsyth also found that there had been an act of bankruptcy. Normally, for a receiving order to be granted in the event that there is only a single creditor, special circumstances must exist. Notwithstanding the fact that the Schlumberger entities in this case were affiliated and should be viewed as a single creditor thereby requiring that special circumstances exist in order to pursue a petition, in this case such

special circumstances existed. These arose as a result of the repeated demands made by Schlumberger for payment, and a letter from Schlumberger to Chauvco International indicating that legal recourse would be taken if necessary. Therefore, an act of bankruptcy had occurred and it could be found that Chauvco International had ceased to meet its obligations "generally as they became due."[245]

Chauvco International also argued that set-off should be available to it in respect of the claim for arbitration proceedings filed by Chauvco Gabon against Schlumberger which, if successful, would be sufficient to set-off the amounts owed to Schlumberger, or that the Court should exercise its discretion and stay the petition for a receiving order. Justice Forsyth held that the case law dealing with a stay of proceedings permitted the Court to stay such proceedings where there is a bona fide dispute to be determined at trial. However, Justice Forsyth considered the issues raised by the pending arbitration and held that there was no bona fide dispute. He noted that the request for arbitration was made only seven days prior to the filing of Schlumberger's bankruptcy petition. He also noted that Chauvco International's letter to Schlumberger proposing the 50 percent discount made no reference to any dissatisfaction with Schlumberger's service, suggesting in fact that there was no dissatisfaction with Schlumberger's oil field practices. This interpretation was also consistent with other facts surrounding the history of Chauvco International's business. All the statutory requirements having been met by the petitioners, Justice Forsyth judged Chauvco International to be bankrupt.

This case indicates that while a company may be an offshore corporation, the existence of an office and employees in Canada may be sufficient to make Canada the company's principal place of business notwithstanding the international nature of its operations.

F. *RE BLUE RANGE RESOURCE CORP.*[246] — TERMINATION AND SET-OFF

The Alberta Court of Appeal reversed the Chambers decision and held that set-off against amounts owing for prior delivery of gas was available to creditors of Blue Range Resource Corporation ("Blue Range") in respect of future losses arising from future non-delivery of gas under certain gas supply agreements. The Chambers Judge, pursuant to an order granted under the *CCAA*, had also allowed termination of those supply agreements whereunder Blue Range was obliged to make future deliveries of natural gas. The Alberta Court of Appeal denied leave to appeal the Chambers Judge's decision with respect to termination.

1. FACTS

Blue Range held certain natural gas leases and was a party to a number of long-term gas supply agreements ("Supply Agreements") with various gas marketing companies, including Engage Energy Canada, L.L.P. ("Engage"), Duke Energy Marketing Limited Partnership ("Duke"), and CanWest Gas Supply Inc. ("CanWest"). As the Supply

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[245] *Chauvco*, *supra* note 243 at para. 26.

[246] (1999), 245 A.R. 154 (Q.B.), rev'd [2000] A.J. No. 830 (C.A.), online: QL (AJ) [hereinafter *Blue Range* — Termination and Set-Off].

Agreements provided for a gas price lower than current spot prices, Blue Range terminated the Supply Agreements in order to attribute a higher value to the corresponding leases. Termination took place on March 31, 1999, after Blue Range had supplied Engage, Duke, and CanWest with gas for February and March under the Supply Agreements. Engage, CanWest, and Duke applied to vary the *CCAA* stay order and Engage and Duke, in the alternative, applied for set-off.

For additional background facts of this case please see the section of this article entitled "Contracts/Industry Agreements."

2. THE CHAMBERS DECISION — ISSUE NO. 1

The Chambers Judge, Justice LoVecchio, identified three issues to be resolved. Issue (i) was was whether a dedication of natural gas supply was an interest in land. This aspect of the decision has been discussed in the "Contracts/Industry Agreements" section of this article.[247] The remaining two issues were as follows:

(ii) whether Blue Range should only be permitted to terminate the Supply Agreements if it was found to be incapable of performing them or if termination was essential to the success of the restructuring; and

(iii) whether Engage and Duke were entitled to set-off their anticipated damages for non-delivery against payments that they owed for natural gas deliveries for the months prior to, and including, February and March.[248]

3. THE CHAMBERS DECISION — ISSUE NO. 2

In resolving the second issue, Justice LoVecchio relied on his resolution of the first issue wherein he decided that the dedicated natural gas supply under the parties' Supply Agreements was not an interest in land. Justice LoVecchio stated that the applicants had "not satisfied the court that it [was] appropriate to vary the order such that Blue Range should only be permitted to terminate the contracts if Blue Range [was] found to be incapable of performing them or that termination [was] essential to the success of restructuring."[249]

The applicants argued that it was unfair for Blue Range to be permitted to terminate the contracts when it had the natural gas to deliver and was capable of performing the contracts. They argued that the only rationale for allowing Blue Range to terminate the contracts was that the contracts were below market value, and termination would therefore allow Blue Range to sell the natural gas at higher rates.

Justice LoVecchio stated that, pursuant to *CCAA* proceedings, contractual relationships are frequently varied. While Blue Range could breach a contract to which it was a party,

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[247] *Supra* notes 66-69 and accompanying text.

[248] *Blue Range* — Termination and Set-Off (Q.B.), *supra* note 246 at 159.

[249] *Blue Range* — Dedicated Gas Supply Agreements, *supra* note 66 at 161.

it must bear the consequences of that breach, including a legitimate claim for damages. However, according to Justice LoVecchio, Duke's and Engage's application would amount to a request for specific performance or an injunction which ought not to be available indirectly. Thus he stated that: "an order authorizing the termination of contracts is appropriate in a restructuring, particularly given that it does not affect the creditors' rights to claim for damages."[250]

In the conclusion to his decision on issue 2, Justice LoVecchio quoted from *Re Dylex Ltd.*[251] with respect to the jurisdiction of the Court in respect of termination by debtor of its contracts:

> It is clear that s.11 of the CCAA gives the power to the court to sanction a plan which includes the termination of leases as part of the debtor's plan of arrangement.... In the interim between the filing and the approval of a plan, the court has the inherent jurisdiction to fill in gaps in legislation so as to give effect to the objects of the CCAA, including the survival program of a debtor until it can present a plan.[252]

Justice LoVecchio then stated that the "termination of these contracts by Blue Range, as an adjunct to the disposition of the leases on favourable economic terms, is necessary to the company's survival program and [was] satisfied that the Court has the necessary jurisdiction to permit termination."[253]

Leave to appeal on the second issue was denied by the Alberta Court of Appeal in a decision dated August 24, 1999.[254] The Court of Appeal noted that "a Chambers Judge has broad discretion under the *CCAA*,"[255] and that Justice LoVecchio was aware of the circumstances, had understood the competing issues, and had attempted to balance the interests of all the parties.

4. THE CHAMBERS DECISION — ISSUE NO. 3

The Chambers decision of Justice LoVecchio on issue 3, has been reversed on appeal. Justice LoVecchio had found that legal set-off did not apply in the circumstances as damages were unliquidated. He also held that the applicants, Engage and Duke, were not entitled to equitable set-off of their anticipated damages for non-delivery of future gas against payments owed by them for prior natural gas deliveries made in the months of February and March 1999. In determining this, he reviewed s. 18.1 of the *CCAA* which reads:

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250 *Ibid.* at 162.
251 (1995), 31 C.B.R. (3d) 106 (Ont. Gen. Div.).
252 *Blue Range* — Termination and Set-Off (Q.B.), *supra* note 246 at 163 citing *Dylex Ltd.*, *ibid.* at 108.
253 *Ibid.*
254 *Re Blue Range Resource Corp.* (1999), 244 A.R. 103 (C.A.).
255 *Ibid.* at 106.

> 18.1. The law of set-off applies to all claims made against a debtor company and to all actions instituted by it for the recovery of debts due to the company in the same manner and to the same extent as if the company were plaintiff or defendant, as the case may be.

In interpreting this section, Justice LoVecchio held that

> [i]t is clear from the wording of this passage that it neither prohibits nor requires the setting-off of obligations by a court but merely states that the law of set-off, with its usual implications, applies to debtor companies. It is necessary then, to look to the principles of set-off in general.[256]

Justice LoVecchio focused on the fact that "set-off provides a creditor with an advantage which other creditors, ranking pari passu except for the set-off, do not have. It puts the advantaged creditor in what is tantamount to a secured position."[257] He resolved this concern by applying the general law of set-off, as described by the Supreme Court of Canada in *Telford* v. *Holt* in the following five enumerated principles:

> 1. The party relying on a set-off must show some equitable ground for being protected against his adversary's demands;
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> ...
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> 2. The equitable ground must go to the very root of the plaintiff's claim before a set-off will be allowed;
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> ...
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> 3. A cross-claim must be so clearly connected with the demand of the plaintiff that it would be manifestly unjust to allow the plaintiff to enforce payment without taking into consideration the cross-claim;
>
> ...
>
> 4. The plaintiff's claim and the cross-claim need not arise out of the same contract; and
>
> ...
>
> 5. Unliquidated claims are on the same footing as liquidated claims.[258]

After enumerating these principles, Justice LoVecchio indicated that "the overriding concern of a Court faced with an application for equitable set-off is fairness whether it be formulated as 'manifestly unfair'"[259] or other similar descriptions. He then concluded that in this case the question was

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256 *Blue Range* — Termination and Set-Off (Q.B.), *supra* note 246 at 164.

257 *Ibid.* at 166, citing *Citibank Canada* v. *Confederation Life Insurance Co. (Liquidation)* (1996), 15 O.T.C. 26 (Gen. Div.) at para. 29.

258 [1987] 2 S.C.R. 193 at 212.

259 *Blue Range* — Termination and Set-Off (Q.B.), *supra* note 246 at 167.

whether the anticipated damages are so closely connected to the payments for February and March natural gas that it would be manifestly unjust or unfair to require Duke and Engage to pay Blue Range for the natural gas without permitting Duke and Engage to set-off their claims for unliquidated damages.[260]

5. THE APPEAL DECISION — ISSUE NO. 3

While the Alberta Court of Appeal appears to have agreed with Justice LoVecchio in his description of the law, it disagreed with his application of the law of set-off. It emphasized that in a *CCAA* context, concerns as to the priority of creditors are irrelevant. Notwithstanding Justice LoVecchio's comments confirming this, the Court of Appeal held that his decision was influenced by concerns as to the priority of creditors. It stated that set-off was available to Duke and Engage and that it was an error to consider the prejudice to other creditors.

The Alberta Court of Appeal also held that, in a general context, the only contentious aspect of the equitable set-off test, as articulated in *Telford* v. *Holt*, was the "close connection test." It held that the Chambers Judge erred in the application of the test. Relying on new jurisprudence which was not available at the time of the Chambers decision, the Court of Appeal held that set-off was available to Duke and Engage.

Specifically, it held the following:

The important point for invoking equitable set-off is the close connection of the transactions. Would it be manifestly unjust to require Duke and Engage to pay the cost of February and March deliveries in view of the fact that they would suffer significant losses due to the early termination of the same contract that called for the delivery of gas in February and March ... such a requirement would be unjust. The contracts in questions are not a discrete series of contracts ... they are long term contracts ... intended to be relied upon as a whole. The fact that the damages owed to Duke and Engage arise after the stay order is not relevant when the obligation arises out of the same contracts. To hold ... that there were no damages owed ... at the time of the February and March deliveries ignores the overall effect and long term nature of these contracts.[261]

G. *RE BLUE RANGE RESOURCE CORP.*[262] — ELIGIBLE FINANCIAL CONTRACTS

This decision of the Alberta Court of Queen's Bench held that master firm gas purchase/sale agreements between Enron Gas Services Canada Corp. ("Enron") and Blue Range and between Enron and Humble Petroleum Marketing Ltd., a subsidiary of Blue Range, were not "eligible financial contracts" as defined in s. 11.1(1) of the *CCAA*. Leave to appeal this decision has been granted by the Alberta Court of Appeal.

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260 *Ibid.* at 169.

261 *Blue Range* — Termination and Set-Off (C.A.), *supra* note 246 at para. 19.

262 (1999), 245 A.R. 172 (Q.B.) [hereinafter *Blue Range* — Eligible Financial Contracts].

1. FACTS

Engage Energy Canada, L.L.P. ("Engage") and Duke Energy Marketing Limited Partnership ("Duke") joined Enron in this application seeking a declaration that certain natural gas supply agreements with Blue Range, which provided for month to month delivery and payment of natural gas, were "eligible financial contracts" pursuant to s. 11.1(2) of the *CCAA* which holds that no order can be made to stay or restrain the exercise of any right to terminate, amend, or claim any accelerated payment under an eligible financial contract.

While the facts are largely as set out in the above-noted discussions of *Re Blue Range Resource Corp.* under the heading of "Contracts/Industry Agreements" and in this section of the article, the stay order provided that all persons with agreements with Blue Range were restrained from accelerating or terminating the agreements, and from exercising any "distress, recission [*sic*], set-off or consolidation of accounts in relation to any indebtedness or obligation in favour of Blue Range ... without the prior written consent of Blue Range ... or the leave of this Honorable Court."[263]

However, the order, in accordance with the *CCAA*,[264] also stated that it did not prohibit any party to an "eligible financial contract" as defined in s. 11.1(1) of the *CCAA* from terminating, amending, or claiming an accelerated payment under such eligible financial contract. Setting off obligations with Blue Range provided that if the "net termination value" determined in accordance with the eligible financial contract was owed by Blue Range to another party to the contract, the other party would be deemed to be a creditor in respect of that net termination value.

2. DECISION

Justice LoVecchio held that these agreements were not "eligible financial contracts." In doing so, he also noted that this may be the first reported case dealing with s. 11.1 of the *CCAA*, which defines eligible financial contracts as, *inter alia*, a "spot, future, forward

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[263] *Ibid.* at 173.

[264] *Supra* note 67, ss. 11.1(1), 11.2.

or other commodity contract"[265] or the identical provision of the *BIA*.[266] Justice LoVecchio pointed out that there was no legislative definition of this provision.

After some discussion of the treatment of similar contracts in the United States, and the legislative reasons which resulted in the inclusion of these provisions in the *CCAA* and the *BIA*, Justice LoVecchio accepted as a guiding principle the distinction between simple supply contracts, which may be contracts which involve the future sale of a commodity, and contracts that are financial in nature. The distinction was as follows:

> [T]he types of contracts encompassed within the definition [of "eligible financial, contracts"] are genuine forward contracts ... not ... ordinary supply-of-goods contracts, which are not essentially financial in character.[267]

Adopting this distinction between "physical" and "financial" contracts as the difference between "eligible financial contracts" and other types of contracts, Justice LoVecchio continued by stating that

> [t]he question whether contracts are one or the other is to be resolved by the intention of the parties. Simply put, if the purpose of the contract is to lead to the actual delivery of the commodity then you do not have a contract which is financial in nature but one which is physical and it should not be found to be an "eligible financial contract." If the purpose of the contract is only financial in nature and is not intended to lead to the actually delivery of the commodity, then you have a contract which is financial in nature not physical and it should be found to be an "eligible financial contract."[268]

Physical contracts are agreements for a firm sale, delivery, and receipt in the future of natural gas, whether or not it is at a floating price. In these transactions, both vendor and

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265 Section 11.1(1) states that an "eligible financial contract" means:
(a) a currency or interest rate swap agreement,
(b) a basis swap agreement;
(c) a spot, future, forward or other foreign exchange agreement,
(d) a cap, collar or floor transaction,
(e) a commodity swap,
(f) a forward rate agreement,
(g) a repurchase or reverse repurchase agreement,
(h) a spot, future, forward or other commodity contract,
(i) an agreement to buy, sell, borrow or lend securities, to clear or settle securities transactions or to act as a depository for securities,
(j) any derivative, combination or option in respect of, or agreement similar to, an agreement or contract referred to in paragraphs (a) to (i),
(k) any master agreement in respect of any agreement or contract referred to in paragraphs (a) to (j),
(l) any master agreement in respect of a master agreement referred to in paragraph (k),
(m) a guarantee of the liabilities under an agreement or contract referred to in paragraphs (a) to (l), or
(n) any agreement of a kind prescribed.

266 *Supra* note 224, s. 65.1(9).

267 *Blue Range* — Eligible Financial Contracts, *supra* note 262 at 177, citing the expert evidence of Kenneth Raisler at trial.

268 *Ibid.*

purchaser expect that an actual trade in the commodity will occur, albeit possibly with a hedge against future volatility.[269]

In financial contracts, no exchange of the commodity is actually contemplated. Such a contract might be a commodity swap arrangement with a counterparty; such an arrangement would be separate from any physical spot sale arrangements. Pursuant to the commodity swap arrangement, the counterparties may make payments to each other based on the price of a specified amount of the commodity. Payments are netted out over the period of the swap.[270]

In arriving at his conclusions, Justice LoVecchio also specifically rejected the proposition that physical transactions could become financial transactions if related swap transactions are entered into under an International Swap Derivatives Association ("ISDA") swap agreement. The reason for this is the difficulty which results in creating a distinction between transactions under a supply agreement which were not also the subject of transactions under an ISDA agreement and those which are. Justice LoVecchio then concluded that notwithstanding the similarities between the master firm gas sales agreements found in this case and the ISDA swap agreements, the master sale agreement contracts were to be "physical" in nature as opposed to "financial." Therefore, they did not constitute "eligible financial contracts" within the meaning of s. 11.1 of the *CCAA*.

This decision outlines criteria by which "eligible financial contracts" are to be distinguished from "physical" commodity contracts. Leave to appeal to the Alberta Court of Appeal has been granted as this decision was the first to deal with the interpretation of "eligible financial contracts" and the first to consider financing vehicles that provide for delivery of product, and as a result of the significant impact this decision may have upon the oil and gas industry generally. As at August 15, 2000, the appeal decision on this important issue had not been released.

H. *RE BLUE RANGE RESOURCES CORP.*[271] — OPERATOR'S LIEN

This unreported decision by Justice Romaine was in respect of an application by ANG Gathering and Processing Ltd. ("ANG") for a declaration against Blue Range that its claim for monies owed to it pursuant to a facilities operator's lien under a gathering and processing agreement was a priority claim within the meaning of a plan of arrangement involving Blue Range.

1. FACTS

A plan of arrangement had been filed relating to Blue Range by Canadian Natural Resources Limited, a creditor of Blue Range and approved by the court. An order

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[269] *Ibid.*

[270] *Ibid.* at 178.

[271] *Re Blue Range Resource Corp.* (22 November 1999), Calgary No. 9901-04070 (Alta. Q.B.) [hereinafter *Blue Range* — Operator's Lien].

initiating *CCAA* proceedings and staying other proceedings ("Order"), was granted March 2, 1999.

In its application, ANG submitted that it possessed a security interest over processed gas belonging to Blue Range as a result of a contractual lien perfected by possession of the Blue Range gas presented for processing at facilities ("Facilities") jointly owned by ANG and Blue Range. It further submitted that its security interest which was perfected by possession, extended to the proceeds of the sale of gas. Alternatively, it submitted that it had a secured claim as a result of an equitable lien arising from its gathering and processing agreement ("Agreement") with Blue Range.

Blue Range, in addition to processing its gas at the Facilities, was also the contract operator of the Facilities until shortly before March 2, 1999. Therefore, until shortly before March 2, 1999, it was running the day-to-day operation of the Facilities. However, by the day that the Order was issued, operatorship had reverted to ANG and Blue Range was no longer operating the plant.

The contractual terms between ANG and Blue Range as contract operator contained a number of clauses giving ANG the right to access and inspect the Facilities while Blue Range was operating the Facilities as contract operator. The terms contained a clause stating that ANG had possession and control of the delivered and processed gas. Finally, the contract between ANG and Blue Range also contained a contractual lien in favour of ANG upon delivery of the gas and an entitlement for Blue Range to dispose of the gas if it was not in default of payment. No financing statement had been registered by ANG at the Personal Property Registry in respect of its contractual lien.

For additional background facts, please see the discussion of *Re Blue Range Resource Corp.* — Operator's Funds[272] in the section of this article entitled "Trusts."

2. DECISION

Justice Romaine commenced her analysis by indicating that in order for ANG to have a priority claim under the plan of arrangement referred to in the Order, ANG must have had an enforceable, perfected security interest on the date that Blue Range became subject to the Order under the *CCAA*.

In analyzing ANG's submissions, Justice Romaine held that the contractual arrangements between ANG did in fact grant a valid lien and charge on Blue Range's gas delivered for processing at the Facilities. However, Justice Romaine found that this interest must have been perfected as of the date of the Order, in order to be effective against a trustee in bankruptcy at that date under the *Personal Property Security Act*.[273]

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[272] *Blue Range* — Operator's Funds, *infra* note 284ff and accompanying text.

[273] S.A. 1988, c. P-4.05 [hereinafter *PPSA*]. Section 20(1) of the *PPSA* reads:

20(1) A security interest...

(b) in collateral is not effective against

(i) a trustee in bankruptcy if the security interest is unperfected at the date of bankruptcy.

As ANG had not registered a financing statement in respect of the gas, she considered whether pursuant to s. 24(1) of the *PPSA* ANG could claim its security interest was perfected by possession of the gas as collateral.

In resolving this issue, Justice Romaine considered the perspective of an outside observer with respect to the possession of the gas by ANG and considered whether ANG's possession of the gas was as collateral for the purpose of securing payment. She found that for the period of time during which Blue Range was acting as operator, that is, until shortly before March 2, 1999, third parties would not have reason to believe that ANG had been given a security interest by Blue Range over the gas pursuant to s. 24(2) of the *PPSA*.

Furthermore, for the period of time in which ANG (and not Blue Range) was operating the Facilities, Justice Romaine found that ANG's possession of the gas was for its normal business as a gas processor, and not as collateral. Therefore, ANG's "possession" was not sufficient to meet the terms of the *PPSA*. In this respect, Justice Romaine explicitly refused to broaden the definition of possession notwithstanding that such a definition may be impractical or uneconomical when the asset in question is natural gas. Justice Romaine specifically noted that ANG had the option of registering a financing statement in order to perfect its security.

This case alerts gas processors to the fact that while a contractual lien may be valid for gas held by them, perfection of such a lien may effectively require the registration of a financing statement.

I. *RE BLUE RANGE RESOURCE CORP.*[274] — SHARE PRICE CLAIMS

This was an application for the determination of preliminary issues relating to a claim by Big Bear Exploration Ltd. ("Big Bear") against Blue Range. Big Bear, the owner of all of the shares of Blue Range, had submitted a claim in tort against Blue Range and others and argued that its claim should rank equally with those of unsecured creditors.

1. FACTS

The respondent, Big Bear, was the sole shareholder of Blue Range. The applicants were the creditors' committee of Blue Range and Enron Canada Corp., a major creditor of Blue Range.

Big Bear had acquired shares of Blue Range for cash through the Toronto Stock Exchange and subsequently made a hostile takeover bid pursuant to which it proposed to pay for the shares of Blue Range by giving the Blue Range shareholders Big Bear shares for each Blue Range share. The takeover bid was accepted by Blue Range shareholders, and Big Bear shares were issued from treasury. After the takeover, Big Bear claimed to have discovered that the Blue Range shares were worthless and that it had relied on

[274] (2000), 76 Alta L.R. (3d) 338 (Q.B.), online: QL (AJ) [hereinafter *Blue Range* — Share Price Claims].

negligent financial information publicly disclosed by Blue Range in deciding to undertake the takeover.

As a result, Big Bear entered into a unanimous shareholders' agreement with Blue Range under which Big Bear took all of the rights and obligations of the Blue Range directors and subsequently caused Blue Range to apply for *CCAA* protection. Such an order was granted on March 2, 1998 ("Order"). After this, Big Bear made a claim against Blue Range for "alleged share exchange loss, transaction costs, and cash share purchase damages."[275]

2. DECISION

Justice Romaine laid out three issues to be decided. The first considered whether, with respect to the alleged share exchange loss, Big Bear was an unsecured creditor of Blue Range and hence ranked equally with other unsecured creditors, or whether its loss was as a shareholder which ranked after the unsecured creditors. The second issue concerned whether, in the event that there was misrepresentation by Blue Range and reliance on this by Big Bear, Big Bear was the proper party to advance the claim for a share exchange loss. The third issue was whether Big Bear was entitled to advance claims in these proceedings for certain heads of damages included in a draft statement of claim submitted to the Court.

In resolving the first issue, Justice Romaine characterized Big Bear's claim. She noted that a tort award to Big Bear could "only represent a return of what Big Bear invested in equity of Blue Range."[276] She stated that "it is that kind of return that is limited by the basic common law principle that shareholders rank after creditors in respect of any return on their equity investment."[277] Justice Romaine then found that "the alleged share exchange loss derives from and is inextricably intertwined with Big Bear's shareholder interest in Blue Range. The nature of the claim is in substance a claim by a shareholder for a return of what was invested qua shareholder, rather than an ordinary tort claim."[278]

Justice Romaine then assessed where, given the nature of the claim, Big Bear should rank in relation to the claims of unsecured creditors. She noted that there were no binding authorities on point on the issue of ranking, and proceeded to analyze related policy issues.

She based the first policy reason on the "fundamental corporate principle that claims of shareholders should rank below those of creditors on an insolvency."[279] She noted that shareholders would be entitled to receive the remaining property of the corporation upon dissolution, and in this case, as Blue Range would effectively be paying out funds

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[275] *Ibid.* at para. 14.
[276] *Ibid.* at para. 23.
[277] *Ibid.*
[278] *Ibid.* at para. 25.
[279] *Ibid.* at para. 29.

to the benefit of its sole shareholder and to the prejudice of third party creditors, Big Bear's claim should not have priority.

A further policy reason supporting the subordination of Big Bear's claim was the recognition that creditors conduct business with corporations on the assumption that they will be given priority over shareholders in the event of an insolvency. This was a risk that Justice Romaine held Big Bear to have accepted.

Finally, Justice Romaine accepted as useful particular American case law which holds that "when a corporation becomes bankrupt, the temptation to lay aside the garb of a stock holder, on one pretence or another, and to assume the role of creditor, is very strong, and all attempts of that kind should be viewed with suspicion."[280] She further noted that in accepting these cases she did not find it

> necessary to adopt the U.S. absolute priority rule to follow the approach [the U.S. cases] espouse, which is based on equitable principles of fairness and policy. There is no principled reason to disregard the approach set out in these cases, which have application to Canadian business and economy, and I have found them useful in considering this issue.[281]

Therefore, Justice Romaine held that based on the

> characterization of the claim, the equitable principles and the consideration set out in the American cases, the general expectations of creditors and shareholders with respect to priority and assumption of risk, and the basic equitable principle that claims of defrauded shareholders should rank after the claims of ordinary creditors in a situation where there are inadequate assets to satisfy all claims ... Big Bear must rank after the unsecured creditors of Blue Range in respect to the alleged share exchange loss, the claim for transaction costs and the claim for cash share purchase damages.[282]

In resolving the second issue, Justice Romaine held that Big Bear was not the proper party to pursue the claim for its loss against Blue Range. Specifically, she noted that while Big Bear had issued shares from treasury, and that these shares would not have been issued but for the alleged misrepresentation, there was no actual loss for the issue of the shares. Therefore, Big Bear's claim for the share exchange loss was qualitatively different than its claim for transaction and other actual costs arising from the alleged negligent misrepresentation. The result was that while subordinate to ordinary creditors, only the latter costs could presumably be claimed by Big Bear. Interestingly, Justice Romaine also noted that no claim was made by Big Bear for any loss relating to a diluted share value.

Finally, in resolving the third issue, Justice Romaine considered claims for oppressive and unfairly prejudicial conduct and loss of opportunity, as well as loss of the ability to raise equity. Justice Romaine held that Big Bear was not entitled to advance these claims as advancing them would be a indirect collateral attack on the effectiveness of orders previously made in this complex circumstance. She further held that the effect of previous

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280 *Ibid.* at para. 43, citing *Newton National Bank* v. *Newbegin*, 74 F. 135 (8th Cir. 1896) at 140.

281 *Blue Range Resource Corp.* — Share Price Claims, *ibid.* at para. 56.

282 *Ibid.* at para. 57

orders was to "prevent Big Bear from advancing its claim other than as identified in its Notice of Claim, which cannot reasonably be interpreted to extend beyond the claims for damages for negligent misrepresentation."[283]

This case appears to incorporate into Canadian law the principle that in an insolvency, claims of shareholders will be subordinate to claims of other creditors, if the claims of the shareholder's may be characterized as primarily arising from their status as shareholder's, rather than their status as creditors.

IX. TRUSTS

A. *RE BLUE RANGE RESOURCE CORP.*[284] — OPERATOR'S FUNDS

This case analyzed payments between an operator and a contract operator of a natural gas processing facility. The contract operator was also a producer processing its gas at the facility, and a part owner of the facility.

1. FACTS

ANG Gathering and Processing Ltd. ("ANG") applied for a declaration that certain funds were held in trust for ANG by Blue Range as the "Contract Operator" of a gas processing facility.

On September 1, 1998 ANG had purchased from Blue Range a 52 percent interest in a compressor station, a natural gas plant, an injection well, and the related gathering system. Blue Range retained a 48 percent ownership in these facilities ("Facilities"). The Facilities were governed by an ownership and operation agreement ("OOA"), a contract operating agreement ("COA"), both between Blue Range and ANG, and gathering and processing agreements ("GPAs") between the "Operator" of the Facilities and Blue Range and other third party producers who processed their natural gas at the Facilities.

ANG was the "Operator" under the OOA between Blue Range and ANG as the "Owners" of the Facilities. However, Blue Range was the "Contract Operator" under the COA, and, therefore, assumed certain of ANG's functions and responsibilities as "Operator" under the OOA. Blue Range also assumed certain of ANG's responsibilities to the producers under the GPAs. In particular, Blue Range was responsible for invoicing the producers for gathering and processing fees as a representative of ANG, and for remitting payments to ANG as operator. As a producer, it was also responsible for collecting fees from itself. The monthly processing fees owed by Blue Range amounted to approximately 70 percent of the revenue of the Facilities. Furthermore, as an Owner and pursuant to the OOA, Blue Range was entitled to a share of the distributions after expenses and allowed expenditures.

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[283] *Ibid.* at para. 82.

[284] [1999] A.J. No. 929 (Alta Q.B.), online: QL (AJ) [hereinafter *Blue Range* — Operator's Funds].

As a result of these arrangements, Blue Range invoiced all third party producers for their share of the gathering and processing fees, and delivered to itself what it characterized as a "internal statement" for its share. Upon receipt of this "internal statement," Blue Range would generate a journal entry to recognize its obligations to pay fees under its GPA. Blue Range would then make a net payment to ANG of ANG's share of the gathering and processing fees earned by the Facilities, less the appropriate deduction by Blue Range for administration and overhead fees.

For additional background facts of this case, please see the discussion above of *Blue Range Resources Corp.* — Operator's Lien in the "Creditors' Rights" section of this article.

2. DECISION

Justice LoVecchio found that under its own GPA, Blue Range had natural gas processed through the Facilities. Along with other producers, it was required to pay gathering and processing fees to the operator, namely ANG. Under the OOA, Blue Range, as an owner, was only obligated to remit to ANG as operator "any balance of its Gathering and Processing Fees payable in excess of its share of the Facilities' revenues for any given month."[285]

Under the COA, Blue Range as "Contract Operator," was responsible for fee collection on behalf of ANG. In this respect, Blue Range, as a producer, was "notionally" paying to itself gathering and processing fees. Justice LoVecchio found that this notional obligation should not be seen to create "anything more or less than its primary obligation to pay those fees as an 'Owner' under the OOA unless the COA changed in some specific fashion the import of the OOA."[286]

Justice LoVecchio characterized the problem with the arrangements as follows:

> [T]here was no interim step to clearly identify an actual payment to itself [*i.e.*, to Blue Range] of those fees and the corresponding "receipt" by Blue Range as Contract Operator.
>
> Stated another way, instead of forwarding 100% of the "Gathering and Processing Fees" derived from the utilization of the facilities, including that by Blue Range to ANG net of administrative and overhead fees as permitted by the COA, Blue Range calculated the split which it would be entitled to receive as a "Owner" of the facilities under the COA, retained it, and then forwarded only a net portion (namely 52%) to ANG.[287]

This accounting procedure led to the disagreement between the parties. Clause 11.6 of the COA read:

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[285] *Ibid.* at para. 6.
[286] *Ibid.* at para. 7.
[287] *Ibid.* at para. 10, 11.

> 11.6 Trust Funds
>
> With the exception of only those funds which the Contractor is entitled to retain for its own benefit hereunder, all funds received by the Contractor from the Producers or others for the account of the Operator shall be dealt with by the Contractor in the manner provided for in this Agreement. All such funds are hereby designated as trust funds and are not to be used by the Contractor for its own purposes. The Contractor may commingle funds *received* by it pursuant to this Agreement with its own funds but such right to commingle is granted to the Contractor as an administrative aid in fulfilment of its duties hereunder and does not alter the characterization of such funds paid to or received by the Contractor as trust funds.[288]

Justice LoVecchio therefore characterized the dispute as follows:

> It is over the impact of this accounting scheme that the disagreement between the parties arises. To be trust money under subclause 11.6 of the COA the funds must have been "received" by Blue Range and Blue Range claims that such an entry should not constitute receipt; ANG claims that it should.[289]

ANG submitted that this mechanism employed by Blue Range was a breach of trust and a breach of the remittance provisions of the COA. ANG further submitted that this breach did not permit ANG to make deductions of the operating and capital costs which ANG as "Operator" would otherwise be able to make. ANG estimated that Blue Range, as "Contract Operator," should hold for ANG $2,808,053.44 in trust for gathering and processing fees for 1998. From this amount, Blue Range could withhold the administrative and overhead fees permitted by the COA. A similar treatment was proposed for amounts to be received for January and February 1999.

Justice LoVecchio held that funds received as gathering and processing fees from third party producers were trust funds to be held by Blue Range for the benefit of ANG as operator on behalf of the owners under subclause 11.6 of the COA. This was as a result of the express trust created by subclause 11.6 of the COA over funds actually received by Blue Range as contract operator. However, the gathering and processing fees that Blue Range as contract operator recorded and credited to itself as a producer were not trust funds *received* by Blue Range and therefore were not subject to the same trust as funds received from third party producers. Furthermore, these were not held for the benefit of the operator, ANG, on behalf of the owners pursuant to subclause 11.6 of the COA.

ANG argued that Blue Range's journal entries in respect of its own gas represented monies "received" by Blue Range under subclause 11.6 of the COA. Blue Range argued that the internal accounting entries were equivalent to an invoicing, required in order to calculate amounts of payments to be made at the appropriate time. Thus, Justice LoVecchio focused on the meaning of the word "received" in interpreting the contracts. He held that Blue Range as a producer was not required to pay Blue Range as contract operator for its share of the gathering and processing fees as long as ANG received net amounts owing to it as an owner under the COA. This interpretation was opposed to that

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288 *Ibid.* at para. 5 [emphasis added].

289 *Ibid.* at para. 12.

which would otherwise hold that Blue Range, as contract operator, was both required to collect payment from all producers, and had constructively received payment from itself upon making the journal entry, this receipt combining with the constructive receipt to make all of the amounts subject to a trust. Justice LoVecchio stated that "to accept ANG's argument, I must find that the parties intended at the time they entered the COA that it, and subclause 11.6 in particular, would govern the payment of fees payable by Blue Range and that the payments would cease to be governed by the OOA."[290]

Interestingly, Justice LoVecchio also found that under the OOA, if Blue Range as an owner defaulted on its payment obligations to ANG, ANG would be an unsecured creditor as an owner for its share of the fees payable by Blue Range, and for Blue Range's share of the operating costs and capital costs chargeable by ANG. However, under the OOA, ANG would be partially protected from the impact of this default by its control of the fees received from the third party producers. It could use Blue Range's 48 percent portion of owner's fees as set-off against the operating and capital costs.

Justice LoVecchio therefore held that to find that a trust exists "through a constructive trust has the effect of upgrading the position of ANG. ANG under the trust arrangement would have access to the entire fee collection of Blue Range, not the net position."[291] However, as the COA was a delegation to Blue Range of ANG's role under the OOA, a delegation involving an upgrade of ANG's position would require a reference in the COA to effectively amend the operation of the OOA. The COA did not do this; thus there was insufficient material with which to impose the trust requested by ANG. Justice LoVecchio then noted that, consistent with this approach, Blue Range would be required to remit to ANG all funds received from other producers.

He therefore concluded that

> [t]he journal entries made by Blue Range to reflect "Gathering and Processing Fees" charged to itself as one of the "Producers" utilizing the Facilities are not to be deemed "funds received by the Contractor from the Producers and others for the account of the Operator" at that point and, as such, are not trust funds by virtue of sub clause 11.6 of the COA. Blue Range's practice of deducting its share of revenues is permissible according to the OOA only from its own fees. All of the fees received from third party producers must be remitted directly to ANG subject only to Blue Range's right to deduct its operation, administrative and overhead fees.[292]

[290] *Ibid.* at para. 37.
[291] *Ibid.* at para. 39.
[292] *Ibid.* at para. 51.

X. TORTS

A. *JONES V. MOBIL OIL CANADA LTD.*[293]

1. FACTS

The plaintiff, Jones, raised cattle on lands which he owned and on adjacent lands which he leased. Mobil Oil Canada Ltd. ("Mobil") owned and operated two oil and gas wells located on Jones' freehold lands and a third well on the leased lands. Also located at one of the well sites was an oil battery and a buried flare pit subsequently reclaimed by Mobil. Mobil's interest in those facilities resulted from its merger with Canadian Superior Oil Ltd. ("Canadian Superior"). Jones grazed his cattle up to and around each of the Mobil well sites. Jones' cattle had, at various times, direct access to the Mobil facilities prior to fencing and indirect access through the fencing and open gates.

Jones sued in negligence and nuisance alleging damages to his cattle as a result of exposure to toxic materials emanating from the Mobil well sites.

2. DECISION

With respect to Jones' negligence claim, Justice Romaine held that Mobil's failure to erect satisfactory and effective fencing on the well sites constituted a breach of its duty of care owed to Jones notwithstanding evidence that the types of fencing installed by Mobil were in accordance with industry standards. Meeting industry standards did not in this case mean that Mobil had discharged its duty to Jones. Rather, because Mobil was aware of the harmful effects of oil and gas contaminants on livestock and of Jones' complaints that the fencing was inadequate, Mobil's standard of care was raised

> beyond general industry standards to a duty to effectively prevent access by cattle.... Mobil was in breach of its duty to erect effective fencing, given the notice it had of the problem and that it had erected more effective fencing at a reasonable cost at other locations in the area.... Mobil, was [also] in breach by failing to provide any fencing for some of its facilities in the earlier years of the period in question.[294]

Justice Romaine also held that Mobil was not liable in negligence for failing to recognize the potential for contamination that could be caused by the flare pit because it had been reclaimed in accordance with the industry standards of the time and because there was insufficient evidence to establish a breach of duty.[295] However, Mobil did not escape liability relating to the flare pit, as Justice Romaine went on to consider whether contamination emanating from the flare pit constituted a nuisance. She held that

> a court must be satisfied that the defendant has done all it reasonably could and all that was practicable to avoid the nuisance, even where, as in this case, the special use the defendant makes of the property benefits the community as a whole. The natural resource industry is a steward of lands in Alberta together with the ranching and farming community, and for policy reasons should bear the burden of the highest

293 (1999), 72 Alta. L.R. (3d) 369 (Q.B.) [hereinafter *Jones*].

294 *Ibid.* at 393-94.

295 *Ibid.* at 395.

> standard of care where there is the possibility of injury arising from nuisance. In this case, I am not satisfied Canadian Superior met this standard of care in its disposal of the flare pit, even if its method of disposal was consistent with past industry practice.[296]

A number of evidentiary issues related to damages were also addressed. Justice Romaine, in concluding that Jones had suffered damages, largely accepted Jones' evidence as more persuasive, and the quantum of those damages was causally connected to Mobil's actions and omissions.

XI. DIRECTORS' LIABILITY AND FIDUCIARY DUTIES

A. *PEOPLES DEPARTMENT STORE INC. (TRUSTEE OF) V. WISE*[297]

This case examines the obligations of directors of a company on the verge of insolvency to creditors of that company.

1. FACTS

Peoples Department Stores Inc. ("Peoples") was a wholly owned subsidiary of Wise Stores Inc. ("Wise"). Both Peoples and Wise were declared bankrupt on December 9, 1994. Three members of the Wise family comprised the entire board of directors of Peoples and were on the board of directors of Wise.

The operating policies of Peoples and Wise involved domestic purchases of products made by Peoples on behalf of both corporations. Wise would obtain its products from Peoples, and Peoples would invoice Wise accordingly. As Wise was in financial difficulty, this policy allowed Wise to obtain inventory from Peoples in exchange for an accounts receivable which Peoples would not be likely ever to collect. Justice Greenberg of the Quebec Superior Court found that it was this policy that caused Peoples to go bankrupt.

2. DECISION

Justice Greenberg concluded that the directors of a wholly owned subsidiary may consider the best interest of the parent corporation and, where those interests overlap or coincide with those of the subsidiary, they may act accordingly. Where those respective interests are not congruent, they must attempt to reconcile the two. Hence, where there is mutuality of interests, there is no problem. However, where the best interests of the subsidiary are in direct conflict with those of the parent corporation, the former must prevail with regard to the actions of the directors of the subsidiary.[298]

The trustee in bankruptcy of Peoples requested that Justice Greenberg consider the notion that Peoples' creditors were "stakeholders" in the corporation to which Peoples' directors owed fiduciary duties. Justice Greenberg entered judgment against the directors of Peoples personally, and cited with approval the following principles:

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296 *Ibid.* at 396.

297 [1998] Q.J. No. 3571 (Qc. C.S.), online: QL (QJ) [hereinafter *Peoples*].

298 *Ibid.* at para. 188.

- Where a company is insolvent or near insolvency, the directors' duties lie not only towards the company's shareholders, but that they are also bound to act in the best interests of the company's creditors.[299] For instance creditors are entitled to consideration if the company is insolvent, near-insolvent, of doubtful solvency, or if a contemplated payment or other course of action would jeopardise its solvency[300];

- An objective test should be adopted: "whether at the time of the payment in question the directors 'should have appreciated' or 'ought to have known' that it was likely to cause loss to creditors or threatened the continued existence of the company"[301];

- In such cases the unanimous consent of shareholders is not enough to justify the breach of duty to the creditors[302]; and

- The company is not bound to pay off every debt as soon as it is incurred and the company is not obliged to avoid all ventures which involve an element of risk, but the company owes a duty to its creditors to keep its property inviolate and available for the repayment of its debts. The conscience of the company, as well as its management, is confided to its directors. A duty is, owned by the directors to the company and to the creditors of the company to ensure that the affairs of the company are properly administered and that its property is not dissipated or exploited.[303]

The reasoning in *Peoples* was cited at length in *Canbook Distribution Corp.* v. *Borins*,[304] where Justice Ground of the Ontario Superior Court, in rejecting a summary judgment application, first noted that Canadian law appears to be moving in the direction of recognizing a fiduciary duty owed by directors to creditors. Justice Ground then concluded that whether a corporation is insolvent at the date of a particular transaction is a question of fact to be determined at trial, as is the question whether the transaction jeopardized the solvency or continued existence of the corporation. This case only recognizes the principles in *Peoples* as triable issues and cannot be held as authority for the application of the principles in Ontario.

These two cases do indicate, however, that where a company is insolvent, or where the company is embarking upon a course of action which will in the short run render it insolvent, the directors owe a fiduciary duty to the creditors of the company to ensure that the company's affairs are properly administered, that its property is not dissipated or exploited, and that its property is kept available for the payment of debts. We are not aware of any appellate authority in Canada that has upheld this principle.

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299 *Ibid.* at para. 190, citing J.G. Ziegel, "Creditors as Corporate Stakeholders: The Quiet Revolution — an Anglo-Canadian Perspective" (1993) 43 U.T.L.J. 511.

300 *Peoples, ibid.* at para. 191, citing *Nicholson* v. *Permakraft (NZ) Ltd.*, [1985] 1 N.Z.L.R. 242 (N.Z.C.A.) [hereinafter *Nicholson*] at 249.

301 *Peoples, ibid.* at para. 192, citing *Nicholson, ibid.* at 250.

302 *Ibid.*

303 *Peoples, ibid.* at para. 197, citing *Winkworth* v. *Edward Baron Development Co.*, [1987] 1 All. E.R. 114 at 118, Templeman L.J.

304 (1999), 45 O.R. (3d) 565 (Sup. Ct.).

XII. LEAVE TO APPEAL TO THE SUPREME COURT OF CANADA

In addition to the references to leave to appeal in cases noted above, we note the following decisions in respect of cases from the last two years' review articles.

- *Rapatax (1987) Inc.* v. *Cantax Corp.*: application for leave to appeal dismissed with costs.[305]

- *United States* v. *Ivey*: application for leave to appeal dismissed with costs.[306]

- *Alberta Wilderness Assn.* v. *Express Pipelines Ltd.*: application for leave to appeal deemed abandoned on March 24, 1997.[307]

- *Paddon Hughes Development Co.* v. *Pancontinental Oil Ltd.*: application for leave to appeal dismissed.[308]

- *Terra Energy Ltd.* v. *Kilborn Engineering Alberta Ltd.*: application for leave to appeal dismissed with costs.[309]

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[305] (1995), 175 A.R. 366 (Q.B.); (1997), 196 A.R. 200 (C.A.); (1997), 212 A.R. 235n (S.C.C.).

[306] (1995), 130 D.L.R. (4th) 674 (Ont. Gen. Div.); (1996), 139 D.L.R. (4th) 570 (Ont. C.A.); (1997), 218 N.R. 159 (S.C.C.).

[307] (1996), 137 D.L.R. (4th) 177 (F.C.A.); [1996] S.C.C.A. No. 534, online: QL (SCCA).

[308] (1995), 173 A.R. 254 (Q.B.); (1998), 223 A.R. 180 (C.A.); (1999), 243 N.R. 199n (S.C.C.).

[309] (1997), 198 A.R. 241 (Q.B.); (1999), 232 A.R. 101 and 297 (C.A.); [1999] S.C.C.A. No. 316, online: QL (SCCA).