RECENT JUDICIAL DEVELOPMENTS OF INTEREST TO OIL AND GAS LAWYERS

DOUGLAS G. MILLS* AND BRIAN BECK**

This article is a compilation of recent Canadian court decisions pertaining to oil and gas law. Case law in the following areas has been surveyed: (1) contracts and torts; (2) lands, leases and titles; (3) royalty agreements; (4) surface rights; (5) offshore drilling; (6) administrative law; (7) environmental law; (8) tax; (9) directors' liability; (10) fiduciary duties; and (11) civil procedure.

Le présent article offre une compilation des décisions judiciaires récentes en matière de droit pétrolier et gazier au Canada. Il examine la jurisprudence dans les domaines suivants : 1) droit contractuel et droit de la responsabilité délictuelle, 2) terres, concessions et titres, 3) ententes au titre des redevances, 4) droits de surface, 5) forage en mer, 6) droit administratif, 7) droit de l'environnement, 8) droit fiscal, 9) responsabilité des administrateurs, 10) obligations fiduciaires et 11) code de procédure civile.

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* Partner, Burnet, Duckworth & Palmer, Calgary, Alberta.
** Associate, Burnet, Duckworth & Palmer, Calgary, Alberta.

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I. INTRODUCTION

This article summarizes and comments upon select judicial decisions from 1996 and 1997 that the authors feel may interest lawyers who practice in the oil and gas industry. The article's coverage has excluded all decisions that were reported upon in previous editions of this series and has included only judgments that were released prior to 30 May 1997 (with the exception of one subsequent appeal decision in respect of which the authors appeared as counsel). The authors offer the usual disclaimers: they have used their judgment in determining what is interesting and important and, therefore, do not pretend that the selection of cases constitutes a complete summary of the year's developments; the authors caution that their description of the cases should not be relied upon in place of the reader's own examination of the cases and other relevant law; and, they emphasize that the views expressed here are those of the authors alone and not necessarily those of Burnet, Duckworth & Palmer nor the Canadian Petroleum Law Foundation.

II. CONTRACTS AND TORTS

A. ECONOMIC LOSS IN CONTRACT AND TORT

1. *PETRIFOND MIDWEST LTD. v. ESSO RESOURCES CANADA LTD.*[1]

a. Facts

The respondent in this appeal, Syncrude Canada Ltd., was the operator of the Syncrude Tar Sands Project at Fort McMurray. All of the shares of Syncrude were owned by the participants in the Syncrude project in the same proportion as their ownership of the project. Syncrude operated the project under the terms of a management agreement which did not give Syncrude any interest in the assets which it operated. Syncrude, as operator, had its expenses paid by the owners and transferred production from the tar sands to each of the owners at the plant gate. Syncrude took no part in the sale or marketing of the production from the project.

In its role as operator, Syncrude contracted with the appellant HMW Constructors Ltd. to excavate a fire hydrant at the plant's site. Syncrude alleged in its claim that while the excavation was under way, the contractor damaged an underground electrical duct bank which resulted in part of the plant being shut down until repairs could be made.

The contractor ultimately sued the operator, Syncrude, and all of the individual owners of the Syncrude facilities in a builders' lien action when Syncrude did not pay for the excavation work. Syncrude defended the action and counterclaimed in its own name only for the alleged loss of production when the plant was shut down. The contractor sought to dismiss that business interruption claim on the basis that Syncrude had suffered no damages and therefore had no right of action in its own name. The trial of an issue was held on the question of whether Syncrude was entitled to bring the business interruption loss claim in its own name. The trial judge determined that Syncrude could maintain the action for the business interruption losses incurred by the owners even though Syncrude itself had suffered no business interruption losses. In so finding, the trial judge relied on principles of bailment law, finding Syncrude to be a bailee in lawful possession of the Syncrude facilities, therefore having requisite authority to sue for both the actual damages to the underground electrical system and for the consequential business interruption losses suffered by the owners. The contractor appealed.

b. Decision

The Alberta Court of Appeal overturned the trial judgment on the basis that the trial judge had erred in treating the relationship between Syncrude and the owners as one of bailor and bailee. It held that it was properly characterized as an agency relationship

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[1] (1996), 42 Alta. L.R. (3d) 157 (C.A.), application for leave to appeal dismissed, [1996] S.C.C.A. No. 523 (QL).

where the agent had no legal or beneficial ownership interest in the business of the principal. The court also found that the provisions of the management agreement limited the ability of Syncrude, as operator, to bring such an action without the consent of the owners. The Court of Appeal determined that the owners had not authorized the action in this case and that they had not brought the claim in their own names. Syncrude itself had suffered no economic loss and the Court of Appeal applied the general rule that only the party suffering the damage could claim for that damage.

The Court of Appeal, after disposing of the appeal on this basis, explained why it was not prepared to extend the principles of bailment law that apply to claims for the replacement or restoration of a chattel to claims for economic losses that flow from the destruction of, or damage to, the chattel in such circumstances (where the economic loss relates to possession of land by a party with no legal or beneficial interest in that land). In all of the circumstances of this case, the court did not believe such an approach was in the interests of commercial expediency.

c. Comments

This case is useful as a reminder to counsel of the need to determine who should be named as proper parties to an action in circumstances where the authority of the named party to bring the action may not be clear. While the court in this case left open the possibility that Syncrude could bring the action in its own name on behalf of the owners if authorized to do so by the owners under the management agreement, the court did not find the necessary authorization in the evidence presented.

2. *BOW VALLEY HUSKY (BERMUDA) LTD.* v. *SAINT JOHN SHIPBUILDING LTD.*[2]

This case, arising from a fire on a semi-submersible drilling rig, was reported on by Hope-Ross and McLelland in the 1996 edition of this series.[3] Leave to appeal the decision to the Supreme Court of Canada was granted and at the time of writing that court was scheduled to hear the appeal during the session that commenced 21 April 1997.[4]

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2 (1995), 126 D.L.R. (4th) 1 (Nfld. C.A.), leave to appeal to S.C.C. granted, [1995] S.C.C.A. No. 352 (QL).

3 W.J. Hope-Ross & K.S. McClelland, "Recent Judicial Developments of Interest to Oil and Gas Lawyers" (1996) 34 Alta. L. Rev. 664 at 724.

4 [1995] S.C.C.A. No. 352 (QL).

B. MISREPRESENTATION

1. *DORNAN PETROLEUM INC.* V. *PETRO-CANADA*[5]

a. Facts

This case involves three separate actions between Petro-Canada and one of its gasoline products wholesalers. The actions resulted from a failed venture in which Dornan Petroleum Inc. (Dornan) had become the Edmonton wholesale marketer for Petro-Canada. The arrangement failed miserably and Dornan sued Petro-Canada for fraud and negligent misrepresentation, breach of contract, improper withholding of monies, punitive damages and personal injury (psychological problems experienced by reason of the loss of the marketer operation). Petro-Canada claimed against Dornan for conversion of accounts receivable belonging to Petro-Canada and for funds owing under a separate retail sales operation. Dornan alleged, among other things, that Petro-Canada had misrepresented, through its pro-forma projections, the profitability of the business.

b. Decision

Murray J. dismissed each of Dornan's claims, determining that Petro-Canada had not misrepresented matters to Dornan, either through the pro-formas or through any other comments made to Dornan with respect to employees, accounts receivable facilities, or the like. The court essentially found that Dornan was the author of its own misfortune.

Murray J. allowed the claims and counterclaims of Petro-Canada in both the marketer action and in the retail action.

c. Comments

This case is very fact-specific but does provide a cursory review and discussion of the law on misrepresentation and collateral warranty in this factual context.

2. *ROYAL BANK OF CANADA* V. *LOGAN*[6]

a. Facts

The defendants operated a number of companies in Canada, the United States, and the Cayman Islands. Their business involved the purchase and sale of sulphur in national and international markets. The plaintiff, Royal Bank of Canada, financed the defendants' business. Under the terms of the defendants' loan agreement, they were obliged to provide the bank with monthly reports disclosing the value of their inventory and accounts receivable. The defendants allowed their loan payments to go into arrears and the plaintiff sued. This action was premised on the bank's allegation that the defendants fraudulently or negligently misrepresented the true value of their inventory

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5 (1995), 42 Alta. L.R. (3d) 369 (Q.B.).

6 (1996), 182 A.R. 264 (Q.B.).

and accounts receivable in the monthly reports and that the three individual defendants had conspired to commit fraud against the bank.

The defendants counterclaimed against the bank alleging that the bank was negligent in its realization of the defendants' security in the course of the receivership.

b. Decision

Medhurst J. dismissed both the claim and the counterclaim. He found that the defendants had not deliberately or negligently misrepresented the value of the accounts receivable and found no evidence that the value of the inventory was incorrect at the time that it was reported by the defendants to the plaintiff bank. In dismissing the defendants' counterclaim, he determined that the bank had acted on proper advice and was not improvident in its realization of the defendants' security.

c. Comments

This case, again very fact-specific, does offer a useful discussion of the law with respect to fraudulent misrepresentation (the tort of deceit), negligent misrepresentation, and civil conspiracy in the factual context of a bank's loan agreement with a company involved in the sale of oil and gas by-products.

C. INDUSTRY STANDARD CONTRACTS

1. *BRINKERHOFF INTERNATIONAL INC.* v. *NUMAC ENERGY INC.*[7]

a. Facts

This case involves an interpretation of clause 12 of the Canadian Association of Oilwell Drilling Contractors (CAODC) Standard Day Work 1993 (Revised) Contract. Specifically, before the court was the issue of whether the contractor or operator bears the risk of loss for physical damage to the contractor's drilling rig in the circumstances of a wild well blow out. The case also addresses the question of whether the operator is obligated to indemnify the contractor for economic loss that results from a wild well blow out.

In this case, the parties proceeded pursuant to r. 220 of the *Alberta Rules of Court*[8] with an agreed statement of facts to address the following specific questions of law:

(1) Pursuant to the CAODC Standard Day Work Contract 1993 (Revised) (the Contract), is the Contractor or Operator liable for the physical damage to the Contractor's drilling rig as a result of a wild well blow out (hereinafter referred to as "physical damage to the rig")?

[7] (1996), 191 A.R. 105 (Q.B.).
[8] Alta. Reg. 390/68.

(2) Pursuant to the Contract, is the Operator obliged to indemnify the Contractor for economic loss resulting from the destruction of the Contractor's equipment (hereinafter referred to as the "economic loss claim")?

On 6 February 1994, a wild well blow out occurred and the plaintiff's rig was destroyed by the ensuing fire. The plaintiff, Brinkerhoff International Inc., was the owner of the rig and was in the process of drilling a well for the defendant operator, Numac Energy Ltd.

The plaintiff alleged that subclause 12.7 required the operator to pay for the damage to the rig. Subclause 12.7 states:

> Wild Well: Operator shall be liable, regardless of the fault or negligence of any person or party or howsoever arising, for the cost of gaining control of any blow out or wild well, as well as the cost of removal of any debris, and shall indemnify Contractor from and against any and all actions, claims, losses, costs, damages, and expenses thereby suffered or incurred by Contractor.

The defendant operator alleged that subclause 12.1 allocated that risk to the plaintiff contractor. Subclause 12.1 provides:

> Contractor Surface Equipment: Contractor shall be liable at all times for any loss, damage to or destruction of Contractor's surface equipment including all drilling tools, machinery and equipment for use above the surface, and other equipment, including down-hole equipment when such down-hole equipment is above the surface regardless of the fault or negligence of any person or a party or howsoever arising except loss, damage or destruction occurring during the time that operations have been taken over by Operator under Clause 6 hereof, or except as provided in Subclause 12.3 or Subclause 16.2 hereof in which case Operator shall be liable and the basis of reimbursement shall be as specified in s. 12.13 (b) of Exhibit "A."

None of the exceptions provided for in subclause 12.1 applied to the facts in this case.

b. Chambers Decision

The Chambers Justice determined that the provisions of subclauses 12.1 and 12.2 which allocate risk with respect to surface equipment and down-hole equipment in the ordinary course were not applicable to a wild well situation because that interpretation would unnecessarily limit the express wording of subclause 12.7 dealing with wild wells.

With respect to the economic loss claim, the Chambers Justice found the provisions of the Contract to be ambiguous on this point and accordingly directed a trial of an issue so as to allow evidence of custom in the industry as an aid in constructing of the language of the contract.

c. Court of Appeal Decision

The Alberta Court of Appeal reversed the learned Chambers Justice, holding that the loss of the rig was covered by clause 12.1 and that clause 12.7 applied only to the two specific types of damage referred to in that clause, specifically, the cost gaining control of a blow out or wild well and the cost of removal of debris. In the result, the Court found the Contractor was liable for the physical damage to its drilling rig resulting from a wild well blow out.

With respect to the economic loss claim, the Court of Appeal held that "the Operator is not obliged to indemnify the Contractor for economic loss resulting from the destruction of the Contractor's rig followed a wild well, unless the Contractor can bring itself under the terms of clause 12.10 of the contract." Clause 12.10, the General Operator's indemnity and liability clause, provides as follows:

> 12.10 Operator's Indemnity and Liability: Subject to the specific limitations contained in this Clause 12 and elsewhere in this Agreement, Operator shall:
>
> (a) be liable to Contractor for such actions, claims, losses, costs, damages and expenses which Contractor may suffer, sustain, pay or incur; and
>
> (b) indemnify Contractor against all actions, claims, losses, costs, damages and expenses brought against Contractor or which Contractor may suffer, sustain, pay or incur, as a result of the negligent or wilful acts or negligent or wilful omissions of Operator and Operator's agents, employees and other contractors arising in connection with the work contemplated by this Agreement.

d. Comments

So far as counsel involved in this case are aware, this is the first judicial interpretation of these provisions in the circumstances of a wild well. We also note that between the time of the Chamber's Decision and the time of the Court of Appeal Decision, the Canadian Association of Oilwell Drilling Contractors made revisions to the Standard CAODC Drilling Contract to "clarify the intent of the CAODC Standard Daywork Contract."[9] The new form of contract would appear to clarify both of the issues considered in this case by confirming the Court of Appeal's decision with respect to property loss and by expressly providing in a new clause (12.11) that neither Contractor nor Operator will be liable for any consequential or economic loss sustained by one another with respect to performance of the work contemplated by the contract.

[9] See CAODC Legal Information Bulletin L-97-1.

2. *MORRISON PETROLEUMS LTD.* v. *PHOENIX CANADA OIL CO.*[10]

a. Facts

The case arose from a joint venture between the parties for the drilling of a relatively deep wild-cat well at Bougie Creek in northeastern British Columbia, apparently a very difficult drilling environment. The plaintiff, Morrison Petroleums Ltd., farmed in and undertook the drilling operation under the terms of a Participation Agreement which incorporated a 1981 Canadian Association of Petroleum Landmen (CAPL) operating procedure.

As described by the trial judge:

> After 104 days from the commencement of drilling operations on June 22, 1990, during which clearly predictable severe problems involving sloughing shale, gas influx, stuck pipe, fractured formations, deviation and lost circulation were repeatedly encountered, Morrison abandoned the Bougie well on October 3, 1990 at a depth of 3131 metres.[11]

The original authorization for expenditure (AFE) cost estimate for the well was $2.1 million. The actual costs of the well were approximately $3.2 million. Morrison did not obtain an approved supplemental AFE for the cost overruns from the defendants prior to incurring those costs and the defendants ultimately refused to pay them. Morrison sued for payment of the defendants' proportionate share of the additional costs incurred over and above the original AFE amounts.

The defendants denied any liability for the cost overruns and counterclaimed for damages for the alleged negligence of Morrison in the planning and drilling of the Bougie Creek well and in Morrison's alleged failure to observe good oilfield practices in planning and drilling the well and in the preparation of the AFE for the drilling operation.

b. Decision

Moshansky J. found that clause 301 of the 1981 CAPL operating procedure created a contractual obligation on the part of Morrison to issue a supplemental AFE to the defendants for any cost overruns for the Bougie well which exceeded 110 percent of the original AFE cost estimate of $2.1 million. He therefore concluded that the defendants were liable to the plaintiff on the main claim only to a maximum of 10 percent over the original AFE amount. He found (contrary to the finding of Sulatycky J. in *Novalta Resources Ltd.* v. *Ortynsky Exploration Ltd.*[12]) that clause 301 did apply to drilling operations as well as recovery operations. Moshansky J. relied upon expert evidence which supported his reading of the 1981 CAPL operating procedure in this regard.

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10 (1997), 98 A.R. 81 (Q.B.) [hereinafter *Morrison*].

11 *Ibid.* at 87.

12 [1994] 6 W.W.R. 484 (Alta. Q.B.) [hereinafter *Novalta*].

Moshansky J. allowed the counterclaim of the defendants, finding that the sum of approximately $1.1 million of overrun costs was attributable to Morrison's poor oilfield practices. However, because the defendants had not paid any of the cost overruns above the original AFE, he found that the "damages to which the defendants would be entitled with respect to the expenditures above the original AFE plus 10 percent, when set-off against the plaintiff's claim, result in one cancelling the other entirely."[13] When the final calculations were done, the defendants owed a total of approximately $97,000 to Morrison for their share of the 10 percent overrun which could be billed to them.

Moshansky J., in finding in favour of the defendants on the negligence issue, held:

(1) "that additional skill, knowledge and experience is required of those who drill wells in the Foothills area of the Rocky Mountains in northeastern British Columbia, as compared to those who drill wells in the flatlands of Alberta";[14]

(2) that the standard of care between an operator and a joint operator was one of ordinary negligence and not one which required gross negligence to found liability;

(3) that negligence can be equated with not following good oilfield practices;

(4) that Morrison "did not act in good faith and was negligent in its planning and preparation of the AFE/cost estimate presented to the defendants";[15]

(5) that the defendants would not have approved over-expenditures in the magnitude of $1.1 million had they been made aware of them in the form of a supplemental AFE.

c. Comments

This decision is of some significance from a practical perspective as it suggests that operators proposing drilling operations in a particular locale may be held to higher standards if the locale is considered a difficult operational area. The case is also interesting in that it directly conflicts with the decision of Sulatycky J. in *Novalta* on the question of whether supplemental AFEs are required to be provided for drilling operations if cost overruns from the original AFEs (in excess of 10 percent) are expected. Counsel wishing to avoid the application of clause 301 in the 1981 CAPL operating procedure should be very careful in drafting language to ensure it is excepted out of drilling operations if that is the intention of the parties. Given the change in wording in clause 301 of the 1990 CAPL operating procedure, the issue should not arise as clause 301(c) provides that cost overruns are specifically included in the original AFE.

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13 *Morrison, supra* note 10 at 158.

14 *Ibid.* at 106.

15 *Ibid.* at 112.

3. *TWO FORTY ENGINEERING LTD. V. PLATTE RIVER RESOURCES LTD.*[16]

a. Facts

This is the appeal court decision of the trial judgment reported on by Hope-Ross and McLelland in the 1996 edition of this series.[17] In this case, Shell Canada Resources Ltd. had farmed out its interest in certain properties to Lochfayne Resources Ltd. which subsequently, by way of a subparticipation agreement and with the consent of Shell, assigned its interests to four different companies, including the appellant, Baton Rouge Holdings Ltd.. The subparticipation agreement contained a clause which provided that a party could only transfer its interest in the farmout lands if it first offered that interest to Shell under clause 10 of the farmout agreement and, in the event Shell elected not to purchase, the subparticipant was required to comply with clause 2401 B of the 1974 CAPL operating procedure.

One of the subparticipants, Platte River Resources Ltd., had assigned its interest in the lands to the Royal Bank and subsequently went into receivership. The receiver sold the interest to the respondent, Two Forty Engineering Ltd. The receiver took the position that because it was a sale of all, or substantially all, of the assets of Platte in Alberta, no right of first refusal was triggered under clause 2401 B of the CAPL, the exception provided for in this regard under clause 2402 being applicable.

The chambers judge found that the sale was not subject to the appellant's right of first refusal as clause 2402 did apply.

b. Decision

The Court of Appeal dismissed the appeal and agreed with the decision of the chambers judge, although for "slightly different reasons."[18] The court found that, on interpreting the subparticipation agreement as a whole and in attempting to read the agreement so as to give meaning to all terms of that contract, clause 2402 was incorporated and therefore applicable.

c. Comments

This result is not surprising on the facts of this case.

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16 (1996), 41 Alta. L.R. (3d) 1 (C.A.) [hereinafter *Two Forty*].

17 *Supra* note 3 at 674.

18 *Two Forty*, *supra* note 16 at 10.

D. NUISANCE

1. *COLONIAL DEVELOPMENTS (IV) LTD.* V. *PETRO-CANADA*[19]

a. Facts

Petro-Canada owned and operated a service station on land adjoining the plaintiff's shopping centre. The Petro-Canada site had been a service station for many years prior to Petro-Canada's ownership. An environmental assessment established that, at some point, hydrocarbons had flowed from Petro-Canada's property onto the plaintiff's property in ground water and that, as a result, vapours had contaminated a restaurant in the shopping centre. In response to the problem, Petro-Canada had proposed a plan whereby the plaintiff might have managed the pollution problem. Whether through failure of that plan or failure of the plaintiff's efforts, however, the pollution problem was not contained. The plaintiff sued in nuisance and applied for summary judgment.

b. Decision

Whether or not Petro-Canada itself allowed gasoline to escape onto the defendant's property, Petro-Canada was nevertheless found liable in nuisance. The remediation program proposed by Petro-Canada was not relevant to the liability issue. Likewise, even if the degree of contamination did not exceed government guidelines, evidence on that point would only constitute evidence of the *degree* of damage suffered by the plaintiff. Similarly, even if the degree of contamination was diminishing at the time of the court application, that trend also would be relevant only to the extent of the damages suffered. The court ordered summary judgment against Petro-Canada accordingly.

III. LANDS, LEASES, AND TITLES

A. *EWING* V. *FRANCISCO PETROLEUM ENTERPRISES INC.*[20]

1. FACTS

The applicant, as lessor, had an oil and gas lease with the respondent lessee. The applicant complained that the respondent had failed to pay royalties in respect of three oil wells. Accordingly, and pursuant to the *Gas and Oil Leases Act*[21] (the *Act*) the applicant applied for a declaration that the lease was null and void and for an order vacating its registration. Pursuant to s. 2(1)(b) of the *Act*, a lessor may apply for such an order when the lessee is in default and has failed to cure the default within thirty days of receiving notice.

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19 (18 December 1996), Calgary 9503/08268 (Alta. Q.B.).

20 [1996] O.J. No. 2348 (Ont. Gen. Div.) (QL).

21 R.S.O. 1990, c. G-3.

2. DECISION

It was clear that there had been a default under the lease, and that it had not been remedied within thirty days. The main issue considered by the court was whether the respondent had received effective notice of that default as required by the statute. On the facts, inasmuch as the respondent had long been aware that the applicant was dissatisfied with how the leases were being managed, the court was willing to consider that a letter from the applicant's lawyer — which threatened an application under the *Act* — sufficed as proper notice of default. With respect to the argument that the lease should be maintained because the respondent was willing to pay the arrears, the Court responded simply that s. 56(b) of the *Act* precludes the court from considering the lessee's willingness to pay after a notice of default has been given. The lease was accordingly declared null and void and vacated from the registry.

B. *RE JAMIESON ESTATE*[22]

1. FACTS

A clause in a last will and testament was in dispute. That clause read: "I GIVE, DEVISE AND BEQUEATH all my property, of every nature and kind and wheresoever situate, to my Executors upon the following trusts, namely: ... (p) TO GIVE my farmlands to Dave Jamieson and Arlene Jamieson, equally or to the survivor of them, ON THE CONDITION that they shall assign the revenues from oil well and gas well leases thereon to Neil Jamieson for his lifetime."[23] There was only one oil well on the farmlands when the testator died. The question arose as to whether the remainderman (Neil Jamieson) or the residuary beneficiaries would be entitled to the revenues from any subsequent leases that might be entered into.

2. DECISION

The remainderman argued that he was entitled to revenues from other leases because the clause in question referred to "leases" and not to "a lease," and because the clause referred to both oil well and *gas well* leases, whereas there was only one *oil well* on the farmlands when the testator died. Notwithstanding these arguments, the court relied upon s. 21 of the *Wills Act*[24] which establishes a rebuttable principle to the effect that a will should be interpreted as taking effect "as if it had been executed immediately before the death of the testator." The Court held that, when the testator died, there was only one oil well, and if the testator had intended to give the remainderman the revenues from subsequent wells, a word such as "future" could have been added to the clause.

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22 [1996] S.J. No. 495 (Q.B.) (QL).

23 *Ibid.* at para. 1.

24 R.S.S. 1978, c. W-14.

C. *WESTERN INDUSTRIAL CLAY PRODUCTS LTD.* v. *KEEPING*[25]

1. FACTS

The respondents were successors in title to federal Crown grants of land in the railway belt of British Columbia. The original homesteader grants in respect of their land reserved "mines and minerals" to the federal Crown. The provincial Crown eventually obtained title from the federal Crown when the railway belt was transferred back to the province in 1930. The appellant corporation was in the business of extracting diatomaceous earth and bentonite from provincial Crown lands adjacent to the respondents' land, and sought a declaration that it was entitled to the diatomaceous earth and bentonite land under the respondents' land as the ultimate beneficiary of the Crown reservation. The trial judge refused the declaration and the appellants appealed.

2. DECISION

The Court of Appeal affirmed the general rule that reservations of "mines and minerals" in Crown grants should be given the widest possible meaning absent a contrary intention evident in the document making the reservation.[26] The court examined the intention of the parties at the time of the grant as evidenced by the vernacular meaning of the word "mineral" at that time (as determined by reference to literary sources and usage in the respective mining and commercial contexts), the nature and composition of the substances in question, the uses made of the substances at that time, and the legislative provisions then existing. The court concluded that diatomaceous earth and bentonite fell within the reservation of "mines and minerals" in the original homesteader grant.

D. *549767 ALBERTA LTD.* v. *TEG HOLDINGS LTD.*[27]

1. FACTS

The plaintiff alleged that two oil and gas leases expired because of an improper shut-in. The issue was whether the wells were "shut-in, suspended or otherwise not produced as a result of, a lack of, or an intermittent, market or lack of transportation facilities or any other cause whatsoever beyond the Lessee's reasonable control."[28] There was never any production from the wells in question, but the defendant company asserted that the wells were properly shut-in due to a lack of transportation, processing capacity and responsive market.

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25 (1997), 143 D.L.R. (4th) 302 (B.C.C.A.).

26 The court followed the decision in *Lord Provost and Magistrates of Glasgow* v. *Farie* (1888), 13 A.C. 657 (H.L.).

27 (3 April 1997), Calgary 9301/15319 (Q.B.), [1997] A.J. No. 321 (QL).

28 *Ibid.* at para. 1.

2. DECISION

The court affirmed the general rule that the onus of proof is on the defendant who argues that non-production is justified by a shut-in proviso. Based upon a review of the evidence, the court held that the wells were not legitimately shut-in, and that the leases had expired accordingly.

E. *FLECK V. DAVIDSON ESTATE*[29]

1. FACTS

The trial decision of this case was reported on in last year's edition of this article.[30] It involved the application by the holder of a clear certificate of title for a declaration that he was entitled to receive certain surface rentals on an oil and gas property notwithstanding a contractual agreement and a course of conduct whereby the surface rentals had been paid to a different party for a number of years.

2. DECISION

The Saskatchewan Court of Appeal upheld the trial decision, confirming that the appellant could not avoid compliance with the terms of a contract he had entered into by attempting to argue that the clear certificate of title allowed him to do so.

3. COMMENTS

As pointed out in last year's article, this decision turns primarily on the fact that there was a contractual arrangement in place between the parties, *i.e.*, this was not the case of a third party stranger to that contractual arrangement taking title without notice of the equitable charge.

F. *FARM CREDIT CORP. V. KERR*[31]

1. FACTS

This case required the Saskatchewan Court of Appeal to determine whether an interest in a surface lease is an interest in land. The trial decision of this case was reported on in last year's edition of this article.[32]

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[29] (1996), 148 Sask. R. 317 (C.A.).

[30] F. Swanson, M. Hurst & E. Rowe, "Recent Judicial Developments of Interest to Oil and Gas Lawyers" (1997) 35 Alta. L. Rev. 413 at 415.

[31] (1996), 148 Sask. R. 245 (C.A.).

[32] *Supra* note 30 at 422.

2. DECISION

The Saskatchewan Court of Appeal upheld the trial judgment and dismissed the appeal. The appellants had attempted to argue that s. 6 of the *Surface Rights Acquisition and Compensation Act*[33] had changed the surface leases into licences. The appellants also argued that the mortgage of the lands (which was the competing claim) was in fact a purchase money security interest and that s. 25(2) of the Saskatchewan *Farm Security Act*[34] precluded the application of s. 8 of the *Distress Act.*[35]

The Saskatchewan Court of Appeal rejected the first argument but was unable to deal with the second as the parties had not agreed in their agreed statement of facts that the mortgage was a purchase money security interest and there was otherwise no basis upon which it could infer that the mortgage had such a status.

G. *CANADIAN NATURAL RESOURCES LTD.* v. *TRINITY ENERGY LTD.*[36]

1. FACTS

Trinity Energy Ltd. obtained the oil and gas rights in respect of the south half of a section of land, and needed to acquire the rights in respect of the north half to make up a spacing unit for drilling. Canadian Natural Resources Ltd. (CNR) owned those rights, but was unwilling to sell them outright. A land swap was proposed, and the closing of the swap transaction was conditional upon the receipt of satisfactory title opinions. No concerns were raised in the title opinion relating to the Trinity lands, but significant concerns were raised in respect of the CNR lands. After those concerns were not resolved to the satisfaction of Trinity, Trinity chose to regard the agreement as at an end. CNR applied to enjoin Trinity from otherwise disposing of the lands subject to the swap agreement.

2. DECISION

The court reviewed the case using the traditional test for an injunction, and in most respects that review was not remarkable. However, when the court asked whether the plaintiff or the defendant would suffer most from an adverse outcome (*i.e.*, when the Court applied the "balance of convenience" test), interesting comments resulted. Zarzeczny J. stated:

> In this case if the injunction is granted the respondent, Trinity,
>
> (1) Will be unable to explore, develop or otherwise deal with the Trinity Lands. It will not, as it has currently proposed, be able to include the Trinity Lands in the bulk or package sale of oil and gas properties which it offered for sale in this region;

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33 R.S.S. 1978, c. S-65.

34 S.S. 1988-1989, c. S-17.1.

35 R.S.S. 1978, c. D-31.

36 [1996] S.J. No. 851 (Q.B.) (QL).

> (2) The CNR may continue to be subject to further depletion of natural gas reserves (as alleged in the respondent's affidavits) by continued production of natural gas from adjacent lands;
>
> (3) Trinity may be committed to the purchase and sale of petroleum and natural gas interests (the CNR lands) in a region in which it appears disinclined to have continuing involvement overall;
>
> (4) The economics of the oil industry and its fluxuating [*sic*] prices for oil and natural gas may work to the advantage or disadvantage of one or the other of the parties including Trinity as a result of this prolonged closing.
>
> Insofar as the position of the applicant is concerned, there is no suggestion in the material as to what its immediate plans are for the Trinity Lands if acquired. Unlike Trinity, it did not suggest that it intended immediate exploratory or other drilling on those lands. Its dilatory action towards clearing or dealing with the title defects or concerns that Trinity has expressed with respect to the state of the CNR title continuing from January, 1996, until the date of the hearing of the application (November 12, 1996) militates against any suggestion that CNR has an agenda for these properties as urgent or timely as was Trinity's.[37]

3. COMMENTS

The court's discussion of factors relevant to the balance of convenience test could be a useful outline whenever an injunction is sought in respect of a failed oil and gas land deal. Especially interesting is the court's recognition that ongoing drainage is a relevant consideration when an injunction is sought.

IV. ROYALTY AGREEMENTS

A. *HARRIS* V. *CINABAR ENTERPRISES LTD.*[38]

1. FACTS

The decision of Macleod J. in this case was reported upon in last year's edition of this article.[39] It is a case which considers the liability of an assignee of a lessee's interest to the holder of an overriding royalty granted by the lessee. In this case, the assignee of the original lessee surrendered the lands and the royalty owner complained that it was not entitled to do so without requiring the party which acquired that interest to recognize its gross overriding royalty.

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37 *Ibid.* at paras. 34-35.

38 (1996), 141 D.L.R. (4th) 410 (Alta. C.A.).

39 *Sub nom. Harris* v. *Nugent* (1995), 32 Alta. L.R. (3d) 126 (Q.B.), commented upon in *supra* note 30 at 429.

2. DECISION

The Alberta Court of Appeal considered the language of the surrender clause in the farmout agreement and the surrender clause in the royalty agreement. In the result, the Alberta Court of Appeal overturned Macleod J.'s decision, determining that, on the language of the contracts between the parties in this case, there was no obligation for the farmee to require the farmor to recognize the gross overriding royalty on surrender of the lands by the farmee.

The court also denied that the farmor's successor was unjustly enriched. Although the former royalty owner had provided geological services in respect of the subject lands and had also brokered the original farmout deal, the court emphasized that the parties entered into a clear contract after those services were provided. The termination of the royalty pursuant to the terms of the contract did not give rise to an unjust enrichment. According to the court, when parties occupy a field with contracts, courts should be reluctant to find gaps and to fill those gaps with unjust enrichment. The court chose not to question a contractual bargain using hindsight.

3. COMMENTS

An application for leave to appeal to the Supreme Court of Canada has been filed in these proceedings, but that no decision in respect of that application has yet been made.[40]

V. SURFACE RIGHTS

A. *BACKER PETROLEUM CORP. V. A.B. HOLLINGWORTH AND SON CONSTRUCTION LTD.*[41]

1. FACTS

The plaintiff sued the corporate defendant in contract and, together with the individual defendant, in tort in respect of the reclamation of a surface lease site. The plaintiff entered into a farm-in agreement with the lessee, Gardiner Oil and Gas Ltd. (Gardiner), and as farmee was responsible for all costs of operation including wellsite-lease payments and the costs of constructing and reclaiming the surface lease. A consulting company arranged for the corporate defendant to build the wellsite, oversee construction and to do the preliminary clean-up work. Gardiner paid the corporate defendant for its preliminary work, and was reimbursed by the plaintiff. Then, when the final clean-up could not be completed because the rig was still on site, the plaintiff undertook to terminate the yearly lease obligations owed to the lessor. In furtherance of this plan, Gardiner assigned its surface lease interest to the plaintiff so that the plaintiff could deal with the lease obligations directly. The plaintiff then contracted with

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[40] See [1997] S.C.C.A. No. 77 (QL).

[41] (4 April 1997), Calgary 9501-02260 (Q.B.), [1997] A.J. No. 322 (QL).

the corporate defendant to "put the lease 'to bed',"[42] and the corporate defendant then completed the reclamation work.

The plaintiff paid the corporate defendant for its work, and applied to Alberta Environment for a reclamation certificate after that work was completed. However, certification of the lease site was refused and the plaintiff's application for a reclamation certificate was cancelled.

2. DECISION

The court rejected the argument that there was an express or implied term of an oral agreement to the effect that the corporate defendant had agreed to complete reclamation of the lease so that the plaintiff could obtain the reclamation certificate. The court noted that additional remedial work was not requested by the plaintiff after completion by the corporate defendant (but before application was made for the certificate), and that the need for such work is in accordance with industry expectations. Moreover, the court noted that a report of another contractor — engaged for the purpose of obtaining the certificate — "strongly indicates that the defendant's work was performed to standard. The work of A.B. Hollingworth and Son Construction Ltd. was done to the standard expected in the industry."[43] The plaintiff's claim in contract was dismissed accordingly, and the allegation of negligence could not succeed given the conclusions in respect of the contract claim.

3. COMMENTS

Unless a contractor expressly guarantees that a reclamation certificate will be available once reclamation work is complete, it is only necessary that the contractor perform the work in a good and workmanlike manner as defined by the practice in the industry.

VI. OFFSHORE DRILLING

A. *OCEANIC EXPLORATION CO. v. DENISON MINES LTD.*[44]

1. FACTS

Oceanic Exploration Co. was part of a consortium that entered into an exploration and development agreement with Greece. That agreement dealt with the exploration and production of hydrocarbons in the Aegean Sea. In 1976, Oceanic sold its rights under the agreement to Denison Mines Ltd. for a purchase price which included an annual "net earnings interest" (NEI). The calculation of this NEI was governed by a NEI agreement, which provided that the NEI was to be 15 percent of the consortium's net revenue (defined in the 1975 agreement as the "contractor's retained net share").

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42 *Ibid.* at para. 3.
43 *Ibid.* at para. 12.
44 [1996] O.J. No. 4387 (Gen. Div.) (QL).

In 1988, the consortium and the state of Greece entered into a first amending agreement. That agreement did not have an immediate effect upon the NEI. Nevertheless, Denison sought Oceanic's consent to the amendment before it was treated as binding between them.

In 1993, a second amending agreement was entered into. For a variety of reasons, but primarily because reservoir production had begun to decline significantly, the consortium and Greece found it necessary to make new arrangements. In the result, the calculation of net revenue was changed in a way that benefited the consortium, Denison and Greece, but that adversely affected Oceanic's calculation of the NEI when the revised revenue figures were used. Oceanic challenged Denison's unilateral amendment of the NEI calculation as first established in 1975, and Denison countered that the NEI agreement incorporated all amendments to the 1975 Agreement by reference.

2. DECISION

The first issue resolved by the court concerned the question of whether the NEI calculation was intended to be amendable over time by Denison. The court suggested that the NEI agreement incorporated by reference the 1975 agreement, but only in a static or frozen form. One interesting proposition supporting this conclusion was that the 1975 agreement mentioned a provision in foreign law, and the court held that when foreign law is incorporated by reference into a contractual document, it is incorporated as a "fact," with the result that subsequent amendments to the law are not automatically incorporated as well.

The court did recognize ambiguities in its interpretation. Some ambiguity resulted from boilerplate language in the 1975 agreement that contemplated its amendment over time. Other ambiguity resulted because the duration of the NEI was fixed in relation to production under the 1975 agreement, but since production only continued pursuant to the second amending agreement, any claim to an NEI payment must of necessity embrace the amendments. However, Feldman J. resolved the ambiguity by reference to commercial reasonableness. According to Feldman J., since the 15 percent net earnings interest was part of the compensation package received by Oceanic when Denison purchased its interest in the consortium, it was not commercially reasonable to suppose that Denison was at liberty to amend the value of that interest without first obtaining input from Oceanic.

Finally, in *obiter* the court addressed the alternative argument to the effect that, if the NEI was referable to the 1975 agreement as amended, then Denison breached its obligation of good faith when it negotiated the second amending agreement by failing to consider Oceanic's interests. Interestingly, however, Feldman J. determined that the contractual obligation of good faith cannot apply unmodified unless the party who allegedly breached that duty had a discretion to act in relation to the other party's interest. Where, as in this case, Denison had obligations to other parties such as the members of the consortium in respect of the amendments negotiated with Greece, Denison was not necessarily free to act in good faith as regards Oceanic. Feldman J. stated:

> All of these difficulties point to the conclusion that the traditional concept of a duty of good faith on a contracting party who has a unilateral discretion to exercise under the contract, does not transfer easily and directly to a situation where that party's ability to effect a change is not unilateral discretion but is circumscribed by duties to others, and the necessity of negotiating with an arms' length third party for the change.[45]

As a result of this conclusion, Feldman J. reasoned that the good faith analysis either buttressed the initial conclusion about the proper way to interpret the contract, or that it would be appropriate, in the circumstances, to imply a term into the original agreement between Oceanic and Denison. Pursuant to the implied term, if Denison were obliged to negotiate a deal that adversely affected Oceanic, the contract would automatically specify that the adverse change would not affect the NEI calculation.

3. COMMENTS

Notwithstanding that the judgment in this case deals primarily with the language of fact-specific contracts, the reasoning may nevertheless be interesting to companies involved in similar ventures. According to the court, in the history of offshore exploration and development, it is typical to encounter both the sort of agreement that was before the court in this case, as well as a course of dealings between parties whereby such an agreement is renegotiated with the foreign state over time. And, of course, Feldman J.'s intriguing comments about the application of the good faith doctrine when a contracting party has contradictory obligations (that restrict or remove the discretion that might otherwise exist) may be extremely important in the context of joint ventures or complicated participation arrangements.

VII. ADMINISTRATIVE LAW

A. ALBERTA ENERGY AND UTILITIES BOARD JURISDICTION

1. *GULF CANADA RESOURCES LTD. V. ULSTER PETROLEUMS LTD.*[46]

An appeal from the trial judgment in this case was heard by the Alberta Court of Appeal in February 1997. The appellate judgment had not been released at the time of writing.

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45 *Ibid.* at para. 75.

46 (1996), 185 A.R. 135 (Q.B.). The trial decision was previously discussed in this series in *supra* note 30 at 432.

B. ENVIRONMENTAL

1. *SARG OILS LTD. V. ALBERTA (ENVIRONMENTAL APPEAL BOARD)*[47]

a. Facts

Sarg Oils Ltd. owned a number of wells but, generally, did little with them. Sarg reconditioned some down-hole equipment and got some production, but did not use the salt-water pits that had been used extensively by its predecessor owners. In the spring of 1988, Sarg sold the wells in question to Sundial Oil and Gas Ltd. for $30,000. Shortly thereafter, in the fall of 1988, Sundial entered the wellsites to rework, test and salvage. In early 1989, Sarg and Mankow, Sarg's shareholder and President, first became aware of Sundial's activities and of a problem with the well licence transfers. By the spring of 1989, the Energy Resources Conservation Board (ERCB) informed Sarg that its application to transfer the licences had initially been delayed because of deficiencies in that application, and that, in the interim, Sundial had contacted the ERCB to say that Sundial was not prepared to accept the transfers unless they could be further assigned to another corporation.

In 1993, the ERCB proceeded with abandonment of the wells and commenced an action against Sarg to recover its costs of $226,000. Also in 1993, reclamation inquiries were commenced in respect of environmental clean-up of the sites. Then, after the *Environmental Protection and Enhancement Act*[48] was proclaimed in force, environmental protection orders were issued against Sarg and Mankow under s. 125 of the *EPEA*. Pursuant to those orders, Sarg and Mankow were directed, in part, to submit an "investigative plan" and a "reclamation plan." Notably, Mankow deposed for court that, according to preliminary investigations, the cost of clean-up to comply with the order may exceed $500,000.

Sarg and Mankow submitted notices of objection to the Environmental Appeal Board (EAB) pursuant to s. 84(1)(f) of the *EPEA*. Primarily, Mankow objected to being characterized as an "operator" under the *EPEA*, and both parties denied undertaking any "activity" at the well sites. Sarg also argued that the system broke down because Sarg, "although technically the licensee on the record of the ERCB, is not the owner because of the sale transaction completed by its solicitors."[49] More generically, the parties complained that the orders made them retroactively liable for clean-up.

At the EAB, the orders against Mankow and Sarg were upheld. The EAB indicated that it is appropriate to consult the ERCB register in order to determine who is an "operator" under the *EPEA*, that the *EPEA* will be widely construed to protect the environment (such that orders against a variety of persons can be made) and that the *EPEA* was intended to have retroactive effect. As a result, the EAB purported to

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47 (1996), 185 A.R. 118 (Q.B.) [hereinafter *Sarg Oils*].

48 S.A. 1992, c. E-13.3 [hereinafter *EPEA*].

49 *Sarg Oils*, *supra* note 47 at 124.

"dismiss" the appeals of Sarg and Mankow. Sarg and Mankow then applied for judicial review.

b. Decision

The applicants initially challenged the EAB's decision with a fettering argument and also challenged the EAB's interpretation of the *EPEA*. In oral argument, however, counsel alleged additional grounds for review that ultimately prevailed. In particular, counsel for the applicants argued that the EAB had breached natural justice in reaching its decision, and that it had failed to conduct its proceedings in accordance with statutory and regulatory requirements. In lucid reasons, Lomas J. tested these latter arguments, and summarized his reasoning in the following passage:

> In this case, Section 86 of the Act refers to the Board conducting a "hearing of the appeal"; regulations 7, 8, 14 and 15 refer to "a hearing" or "the hearing" and regulations 14 and 15 refer to, a party's right "to direct questions" and to make "closing remarks" at a hearing; the Board invited both counsel to make submissions concerning a prehearing meeting and, understand, each counsel requested such a meeting; the Applicants clearly requested that an oral hearing be held, no hearing was ever held but the Board never responded to that request even though it undertook to be in further contact with counsel after considering the information submitted. In my opinion, in view of that background, the failure to hold an oral hearing, or at the very least advising counsel that no oral hearing would be held and giving counsel the opportunity to make further representations concerning the material filed, amounted to a denial of natural justice. Further, as mentioned above, the Board exceeded its jurisdiction by purporting to dismiss the appeals when it only had the power to make recommendations to the Minister.[50]

Lomas J. then rejected the invitation to uphold the orders on the dubious ground that a hearing would have made no difference to the outcome[51] and remitted the matter back to the EAB for consideration.

2. *GULF CANADA RESOURCES LTD.* V. *ALBERTA (MINISTER OF ENVIRONMENTAL PROTECTION)*[52]

a. Facts

Gulf Canada Resources constructed a wellsite on the landowners' property in 1988. The well was abandoned in 1989, and site restoration was completed that year. In 1993, independent consultants were hired to confirm that Gulf had satisfied the necessary requirements for the issuance of a reclamation certificate pursuant to the *EAPA*. In 1994, Gulf applied for such a certificate, an inquiry was held at the wellsite, and a

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50 *Ibid.* at 134.

51 This argument was primarily based on *Mobil Oil Canada Ltd.* v. *Canada (Canada-Newfoundland Offshore Petroleum Board)*, [1994] 1 S.C.R. 202 [hereinafter *Mobil Oil*], in which a unanimous Supreme Court of Canada was willing to overlook a breach of natural justice in circumstances where the outcome was "inevitable" in any event. In terms of its administrative law role, the exceptional nature of the principle expressed in *Mobil Oil* can hardly be overstated.

52 (1996), 42 Alta. L.R. (3d) 336 (Q.B.) [hereinafter *Gulf* v. *Alberta*].

Certificate was issued to Gulf. Later that year, the landowners filed a notice of appeal with the EAB. The EAB recommended to the minister that the appeal be allowed and that Gulf be required to re-apply for a new reclamation certificate. The minister agreed with this recommendation and made an order accordingly. Gulf applied for judicial review.

b. Decision

The court first noted that the appropriate standard for review in respect of matters within the EAB's jurisdiction is "patent unreasonability," whereas the "correctness" test applies to jurisdictional issues. The court cited *Union des employés de service, local 298* v. *Bibeault*[53] for the proposition that, when determining whether an issue is jurisdictional, the analysis should be "pragmatic and functional."[54] The court then proceeded to review the statutory and regulatory context and concluded that the *EAPA* permits an appeal with respect to the issuance of a reclamation certificate, such that the EAB did not exceed its jurisdiction in hearing the landowners' appeal.

With respect to whether the EAB's decision was patently unreasonable, the Court held that s. 87(2)(d) of the *EAPA* permits the EAB to accept new information that was not available when the original decision was made. The court noted that the landowners had isolated the wellsite since the reclamation certificate was issued, and had noted that there was a difference in vegetation between the isolated land and the surrounding areas. Also, a white substance (possibly calcium) had appeared on the surface of the wellsite since the time of the wellsite inquiry. The court was satisfied that this new information was properly considered by the EAB, and that the original decision-makers would have considered the information if it had been available originally. Accordingly, the court dismissed the argument that the EAB was applying criteria different from the criteria prescribed by regulation and followed during the original wellsite inquiry.

c. Comments

Gulf argued that to require it to re-apply for a reclamation certificate runs contrary to the industry need for certainty in respect of reclamation criteria. To the extent the court's decision frustrates this industry need, the court chose to emphasize the statutory structure: "The legislation ... provides a long period of appeal and also provides for the introduction of new evidence that was not available at the time the original decision was made."[55] To the extent it exists at all within the *Act*, certainty in respect of reclamation criteria is apparently a very limited goal.

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[53] [1988] 2 S.C.R. 1048.

[54] *Gulf* v. *Alberta*, *supra* note 52 at 341.

[55] *Ibid.* at 344.

3. *SOCIÉTÉ POUR VAINCRE LA POLLUTION* V. *CANADA (MINISTER OF THE ENVIRONMENT)*[56]

a. Facts

The *Irving Whale* sank in 1974. It rested on the seabed of the Gulf of St. Lawrence and was estimated to contain about 3,113 metric tons of oil. After the options for dealing with the sunken and leaking barge were evaluated, the government decided in favour of a plan to raise the barge and move it to drydock where its cargo could be recovered. This recovery project was subjected to a pair of environmental assessments pursuant to s. 10 of the *Environmental Assessment and Review Process Guidelines Order*.[57] Both assessments concluded that the potential adverse environmental effects of the project would be "insignificant or mitigable with known technology," such that further environmental review was not required unless public concern made a public review desirable. Subsequently, when the recovery project was about to commence, J.D. Irving Ltd. advised the Department of the Environment that there were polychlorinated biphenyles (PCBs) aboard the *Irving Whale*. Fresh environmental assessments resulted, and it was ultimately concluded that "the environmental impact of the recovery of the Irving Whale in light of the presence of PCBs is insignificant, or mitigable with known technology."[58] The applicant environmental organization argued as a preliminary matter that the *EARP Guidelines Order* did not apply, having regard for the transitional provisions in the *Canadian Environmental Protection Act*.[59] Leaving aside this fact-specific point, the applicants also argued that the minister's decision to proceed with the project was made without full consideration of all environmental effects, and that the decision was otherwise unreasonable.

b. Decision

Reed J. applied a test of reasonableness to the decisions made by the relevant departments. After reviewing a number of documents that ultimately favoured the recovery project, she concluded that the government's "conclusion is based on extensive information, documentation, analysis and expertise. On the basis of the material on the file, I could not conclude that the decision is unreasonable."[60]

c. Comments

The *Irving Whale* case is interesting not because of its application of administrative law principles, but the manner in which clean-up was handled. The outcome of the environmental assessments was that the risks of proceeding were insignificant or otherwise mitigable, and Reed J. was not prepared to interfere with that conclusion. What *really* separated the parties in this case was a dispute about whether the

56 (1996), 136 D.L.R. (4th) 747 (F.C.T.D.) [hereinafter *Irving Whale*].
57 SOR/84-467 [hereinafter "*EARP Guidelines Order*"].
58 *Irving Whale*, *supra* note 56 at 753.
59 R.S.C. 1985, c. 16 (4th Supp.).
60 *Irving Whale*, *supra* note 56 at 765.

government's plan was the best one, inasmuch as the environmental organization favoured a plan to pump the cargo out of the sunken barge. In other words, while both sides could agree that doing nothing would not suffice, "[t]he difference between the applicant and the respondent on this point is that the applicant expects a major spill of PCBs while the respondents do not."[61] When an existing environmental hazard demands a response, the environmental question that must ultimately be asked is whether the planned response is associated with insignificant or mitigable effects, or whether that response is associated with potentially significant effects which are nevertheless worth risking. In this regard, Reed J.'s final comment is the most telling of all:

> if there has been a lack of candidness about the degree of uncertainty which exists, the quantity of PCBs likely to be released or about the potentially adverse consequences arising therefrom, which judgments form the basis of the Assessment that has been given, then, this Court, and perhaps the public took, will have been misled.[62]

4. *ALBERTA WILDERNESS ASSOCIATION* v. *EXPRESS PIPELINES LTD.*[63]

a. Facts

This is a short oral judgment of the Federal Court of Appeal. The facts pertaining to the environmental review at issue are not made clear in the report, except inasmuch as the report notes that the case involved "a proposed underground crude oil pipeline to be constructed by Express Pipelines Ltd. from Hardisty Alberta to the U.S. Border at Wildhorse Alberta and onward to Casper Wyoming (the Project)."[64] Leaving aside the procedural niceties of the case, it involved an application for judicial review of the decision of the panel that was charged with assessing the project under the *Canadian Environmental Assessment Act.*[65] The Governor in Council had considered the panel's report (and a dissent) and concluded that "the Project is not likely to cause significant adverse environmental effects."[66]

b. Decision

Four interesting points emerge from the judgment of Hugesson J.A. First, he critiqued most of the applicants' submissions on the basis that they amounted to nothing more than an attack on the quality of the evidence before the review panel and the decisions the panel reached based upon that evidence. Hugesson J.A. indicated that the new environmental legislation is ultimately intended to measure the "significance" of the environmental effects of an assessed project, (*see* s. 37 of the *CEEA*) and stated "that is not a fixed or wholly objective standard and contains a large measure of

61 *Ibid.* at 761.
62 *Ibid.* at 765.
63 (1996), 137 D.L.R. (4th) 177 (F.C.A.), application for leave to appeal filed 30 October 1996, [1996] S.C.C.A. No. 534 (QL) [hereinafter *Alberta Wilderness Association*].
64 *Ibid.* at 179.
65 S.C. 1992, c. 37 [hereinafter *CEEA*].
66 *Alberta Wilderness Association*, *supra* note 63 at 183.

opinion and judgment."[67] Secondly, Hugesson J.A. indicated that when the minister determined that the scope of the panel's review would involve assessing a project with two termini in different countries, "the panel has no duty to study alternative means of carrying out the project which would involve different terminal points."[68] Thirdly, in respect of the factors that a panel must consider when studying a project listed in s. 16 of the *CEEA*, Hugesson J.A. denied that a panel must consider such factors sequentially or in isolation from the anticipated potential to mitigate such effects. In Hugesson J.A.'s words, "there can be no purpose whatever in considering purely hypothetical environmental effects when it is known and proposed that such effects can and will be mitigated by appropriate measures."[69] Fourthly, Hugesson J.A. denied that the panel had improperly delegated its functions by simply recommending that further studies and ongoing reports be made to the National Energy Board before, during and after construction of the project. After all, stated Hugesson J.A., the review panel's function is *limited* to gathering information and making recommendations, so the mere contemplation of further studies does not necessarily indicate that improper delegation has occurred. In this context, Hugesson J.A. also commented upon the fact that environmental assessment is by its nature predictive of the future, such that finality and certainty can never truly be achieved.

c. Comments

All lawyers interested in environmental law will want to read *Alberta Wilderness Association* as it is the first statement from the Federal Court of Appeal under the new *CEEA*. Although a short oral judgment, the case includes a surprising number of purposive statements regarding the new legislation and regarding environmental assessment in general.

5. *COALITION OF CITIZENS IMPACTED BY THE CAROLINE SHELL PLANT V. ALBERTA (ENERGY AND UTILITIES BOARD)*[70]

a. Facts

Shell applied for a throughput increase for its Caroline sour gas plant. At an earlier date, the Alberta Energy and Utilities Board (AEUB) had approved Shell's operation of the plant and fixed feed limits and operating parameters. Since that date, Shell had operated the plant with an actual recovery rate for sulphur that was better than the one approved, with the result that its annual average daily emission level of sulphur dioxide was well below the approved level. Shell's application contemplated an increase in the inlet volume for the plant, the same approved recovery rate for sulphur, and the same maximum daily emissions (the "burp" limit) for sulphur dioxide. The necessary implication of Shell's application was that the approved annual average daily emissions would increase as a consequence of the increase in the inlet volume, although if the

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67 *Ibid.* at 181.
68 *Ibid.* at 182.
69 *Ibid.*
70 (1996), 41 Alta. L.R. (3d) 374 (C.A.).

actual recovery rate remained better than the approved recovery rate, the actual average daily emissions would remain well below the level *originally* approved.

The AEUB decided to hold a public hearing into Shell's application. As a preliminary matter, it conducted a pre-hearing meeting to determine, in part, the nature and scope of the evidence it would receive during that hearing. In terms of scope, the AEUB decided that the hearing would deal with "the possible impacts that may occur from the processing of the incremental raw inlet gas and sulphur."[71] In terms of evidence, the AEUB wrote the following:

> The Board does recognize some ongoing concerns within the community about potential health effects on animals due to oil and gas operations in general. The Board considers this to be a generic issue in Alberta which would include plants such as the Caroline facility. The Board is aware that this broad issue is presently being reviewed by the Alberta Cattle Commission and understands that the results will be available soon. Accordingly, the Board does not intend to receive evidence or consider site specific effects on cattle as part of the upcoming hearing or in the additional process to follow up on concerns about the operation of the Caroline facility. It will rely on the findings of the Alberta Cattle Commission study as a catalyst for ongoing work, and will work with the other parties to address the concerns raised by the findings. The Board believes that this approach will be more effective and appropriate than considering it in the context of only one plant.[72]

The Coalition of Citizens Impacted by the Caroline Shell Plant obtained leave to appeal the AEUB decision to the Court of Appeal and argued three points: (1) that the AEUB made a jurisdictional error in that its decision constituted a refusal to consider "whether the project is in the public interest, having regard to the social and economic effects of the project...," as required by s. 2.1 of the *Energy Resources Conservation Act*[73]; (2) that the AEUB erred in law by determining that evidence of the site-specific effects of the increased emission level on cattle was not relevant; and (3) that the AEUB denied natural justice and contradicted the *Administrative Procedures Act*[74] by refusing the appellant the opportunity to present relevant evidence in the circumstances.

b. Decision

All members of the Court of Appeal agreed upon the principles of administrative law relevant to the decision: a correctness test was to apply in respect of jurisdictional errors, and a test of patent unreasonableness was to apply in respect of legal errors within the jurisdiction of the AEUB. In other respects, the court split sharply when it interpreted the reasons of the AEUB. For the majority, O'Leary J.A. (Hunt J.A. concurring) interpreted the AEUB's reasons to mean that evidence as to the effect of emissions on cattle was treated as *irrelevant* by the AEUB's when it assessed the public interest under s. 2.1 of the *ERCA*, having regard to the fact that this issue was thoroughly canvassed during the original hearings. In dissent, Conrad J.A. interpreted

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71 *Ibid.* at 376.

72 *Ibid.* at 380-81.

73 R.S.A. 1980, c. E-11 [hereinafter *ERCA*].

74 R.S.A. 1980, c. A-2.

the AEUB's reasons to mean that the AEUB believed the evidence in question to be relevant, but simply chose to await the report of the Alberta Cattle Commission rather than to hear such evidence itself, with the result that it failed in its duty to assess the public interest under s. 2.1. The conclusions on the other issues essentially fell into place having regard to this basic division in the court. The majority readily concluded that the AEUB's assessment of relevance was reasonable, especially in light of the high level of curial deference that the AEUB was due, whereas the dissent thought this conclusion would have been patently unreasonable if it had been reached (although the dissent read the AEUB's reasons differently). Finally, the majority found no breach of the principles of natural justice or the *Administrative Procedures Act*, since the refusal to hear evidence was not characterized as a refusal to hear *relevant* evidence, whereas the dissent thought that the AEUB had, indeed, wrongly refused to hear relevant evidence.

c. Comments

The majority of the Court of Appeal was generous in its interpretation of the AEUB's reasons. It is easy to read those reasons the way that Conrad J.A. did, namely, as an admission by the AEUB that evidence about health effects upon cattle was relevant, but that since that particular kind of "public interest" constitutes an Alberta-wide issue, it was convenient for the AEUB to await the report of another specialized body rather than to hear evidence itself. It is much harder to read the reasons the way the majority did. How can health effects on cattle be a "generic issue" in Alberta without, at the same time, being relevant throughout Alberta and, therefore, relevant to the application by Shell? Shell's history of bettering the approved level of annual average daily emissions was no doubt an important fact in this case, notwithstanding Conrad J.A.'s efforts to explain why that fact should not have been material.

C. SURFACE RIGHTS

1. *JENKINS* V. *ALBERTA (SURFACE RIGHTS BOARD)*[75]

a. Facts

A private right-of-way agreement between landowners and an operator gave the operator the right to construct, operate and maintain pipelines and related items on the owners' land. The owners alleged that the operator damaged those lands, and a dispute arose regarding the payment of compensation by the operator. Notwithstanding that the right-of-way agreement contained a mandatory arbitration clause dealing specifically with compensation for damages, the owners applied to the Surface Rights Board (the Board) under s. 33 of the *Surface Rights Act*[76], for a hearing to determine the damages payable. Initially, the Board refused to entertain the application on the basis that

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75 (1996), 45 Alta. L.R. (3d) 321 (Q.B.) [hereinafter *Jenkins*].

76 S.A. 1983, c. S-27.1 [hereinafter *SRA*].

compensation hearings ordinarily proceed under s. 25.[77] Then, when the owners requested that the Board reconsider, the Board wrote to the owners to say that, under the *SRA*, the intent is that the Board will not "become involved in the private contractual dealings between parties."[78] The Board also stated that it was "not prepared to interpret s. 33(3) ... to restrict its interpretation to files related to Right of Entry orders," with the result that "the application herein is declined as being beyond the jurisdiction of the Board."[79]

b. Decision

The owners sought judicial review at the Court of Queen's Bench. Gallant J. noted that this was the appropriate form of proceedings, rather than an appeal as provided for in the *SRA*, since the Board's conclusion that it lacked jurisdiction was not an appealable decision under the *SRA*. With respect to the substantive issues, Gallant J. first stated that, in the scheme of the *SRA*, ss. 20 to 26 provide for the making of "right of entry orders" and for attendant compensation orders. Gallant J. compared this to s. 33 of the *SRA*, which deals more broadly with disputes between parties to a "surface lease" (that term being statutorily defined and being broad enough to embrace the private right-of-way agreement at issue). According to Gallant J., s. 33 provides for hearings to be held at the discretion of the Board, whereas hearings under ss. 20 to 26 are mandatory. Gallant J. was inclined to believe that "[t]he election of the Board not to hear and determine the matter for want of jurisdiction would be a sufficient indication that it elects not to hold a hearing under s. 33."[80] Gallant J. then similarly refused to exercise discretion in favour of the landowners on the basis that the agreement provided for arbitration, such that the parties "should be left to that method of resolution in the absence of a strong reason to the contrary."[81] Gallant J. specifically held that s. 2 of the *SRA* is no bar to an arbitration clause dealing with compensation because s. 2 "deals with conflict between the *Act* (the *SRA*) and any contractual provision relating to the 'right of entry...'"[82] as opposed to compensation for damage.

c. Comments

It is hard to quarrel with the result in *Jenkins*. As Gallant J. noted, s. 33 of the *SRA* seems to contemplate permissive hearings in respect of private right-of-way agreements (surface leases). It makes sense that the Board would refuse to hear a dispute about compensation if such an agreement provides for arbitration on that very point. Also, it seems clear that not all of the landowner claims in *Jenkins* were compensable under s.

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77 Note that s. 25 actually operates to structure how compensation will be determined, assuming that a compensation hearing is otherwise to be held. The true authority for such hearings is found in s. 23 in respect of initial compensation determinations, and s. 27 in respect of subsequent determinations.

78 *Jenkins*, *supra* note 75 at 324.

79 *Ibid.*

80 *Ibid.* at 327.

81 *Ibid.* at 328.

82 *Ibid.* at 329.

33 of the *SRA*.[83] What is less clear is whether the bottom line was properly reached in *Jenkins*. The Board refused to hear the owners' application on the basis that it lacked jurisdiction. Clearly, Gallant J. disagreed that the Board lacked jurisdiction. But why then was Gallant J. so ready to assume that the Board would have refused jurisdiction, given that the Board was apparently unaware that its governing statute permits hearings with respect to private right-of-way agreements? Perhaps the answer can be found in the forms of relief requested by the landowners. In particular, the landowners sought *mandamus* to require the Board to hear and decide the case on its merits, when presumably what the landowners should have sought was an order compelling the Board to reconsider their application in light of a correct understanding of its jurisdiction. In this context, Gallant J.'s decision to forego a reference back to the Board is understandable and, in any event it seems clear enough that the Board would have refused to hear the case if given a choice.[84] Certainly today, in light of the decision of Gallant J., and where there is an arbitration clause, the Board would be wrong to hear a private compensation dispute in the absence of a strong reason for doing so.

2. *ALBERTA (ATTORNEY GENERAL)* V. *WESTCOAST ENERGY INC.*[85]

a. Facts

This was an application for judicial review, and, more specifically, a motion to quash a reference filed by the National Energy Board (NEB). The NEB had previously approved an application by Nova Gas Clearinghouse Pipeline Ltd. for the construction and operation of a section of pipeline to transport gas across the border between B.C. and Alberta. The NEB granted the application under s. 58 of the *National Energy Board Act*[86] on the basis that it was an interprovincial pipeline less than forty kilometres in length. On that basis, the applicant was not required to comply with the more onerous provisions of s. 52 of the *NEBA*. Westcoast Energy Inc. had opposed the application on the basis that the Pesh Creek Pipeline was only a part of the larger pipeline undertaking which included the Peggo Facility in British Columbia and the Alberta extension facilities which comprised more than 40 kilometres in length. The NEB ultimately granted the application under s. 58 after a hearing.

Westcoast subsequently sought leave to appeal that decision but that application was ultimately denied because the pipeline had already been built and was in full operation by the time the matter came on for appeal.

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83 The landowners in *Jenkins*, *ibid.* sought compensation for damage that occurred to the right-of-way lands whereas s. 33(1) primarily deals with compensation for damage that occurs to lands outside of the right-of-way lands.

84 *Jenkins*, *ibid.* is one of those cases in which the substantive issue is resolved by the court on judicial review, without regard for the fact that the regulatory tribunal has not held a proper hearing on the question. In this regard, see *Mobil Oil*, *supra* note 51.

85 (1997), 208 N.R. 154 (F.C.A.) [hereinafter *Westcoast* v. *Alberta*].

86 R.S.C. 1985, c. N-7 [hereinafter *NEBA*].

The NEB subsequently filed the reference in this case which dealt with the constitutional jurisdiction over both the B.C. and Alberta facilities. The question posed was stated as follows:

> Are the connecting facilities, or any of them, together with the facilities approved by the National Energy Board in the decision G.H.-1-96 and Order XGN-62-5-96, issued 22 January 1996, interprovincial works or undertakings in accordance with the provisions of sections 91(29) and 92(10)(a) of the *Constitution Act*, 1987 [*sic*]-1982?[87]

This was the reference which the applicant sought to quash.

b. Decision

The Federal Court of Appeal granted the application to quash the reference on the basis that the question posed would have no immediate and direct effect on any proceeding underlying it. The court confirmed its position that it was not "empowered to determine academic questions of law or to engage in speculation; its role is to determine as opposed merely to consider."[88]

D. ASSESSMENTS AND TAXATION

1. *MINBURN NO. 27 (COUNTY) V. POCO PETROLEUMS LTD.*[89]

a. Facts

The County of Minburn No. 27 applied for judicial review after the Municipal Government Board reversed the County's tax assessment. Under the County's assessment, certain scrubbers, separators and underground storage tanks were assessed as taxable "improvements," that term being defined by s. 1(n) of the *Municipal Taxation Act*.[90] The two respondent companies had objected to this initial assessment on the basis that the so-called improvements were also taxable as "pipeline" under the *Electric Power and Pipe Line Assessment Act*.[91] The companies complained of double taxation and asserted that the "pipeline" assessment was the proper one. The Board agreed with the companies and characterized the wellsite equipment as "incidental production equipment." As a result, the Board concluded that the equipment was clearly taxable under the *Electric Power and Pipe Line Assessment Act* and that it was automatically excluded from taxation under the *Municipal Taxation Act* pursuant to s. 24(1)(o).

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87 *Westcoast* v. *Alberta*, *supra* note 85 at 157.

88 *Ibid.* at 158.

89 (1996), 195 A.R. 146 (Q.B.) [hereinafter *Minburn*].

90 R.S.A. 1980, c. M-31, as rep. by *Municipal Government Act*, S.A. 1994, c. M-26.1.

91 R.S.A. 1980, c. E-5, as rep. by *Municipal Government Act*, *ibid.*

b. Decision

The County argued that there were a number of errors apparent on the face of the record produced by the Board. Ultimately, however, the court indicated that the allegations of error all amounted to allegations concerning the sufficiency of the evidence the Board considered in reaching its decision. This characterization led the court to an easy solution, inasmuch as there was no complete record of the evidence before the Board.[92] The court reasoned that it could not question the Board's determination because "there is no way in which this Court can evaluate the evidence to determine whether or not there was evidence to support the position taken by the Board."[93]

c. Comments

The problem of a court finding itself unable to review a tribunal's decision because of the absence of an effective "record" is not a new one, but it is still somewhat unsettling to think that a tribunal empowered to hear *viva voce* evidence about taxation can avoid scrutiny by failing to record that testimony in a transcript. Leaving aside this point, the most interesting feature of *Minburn* is the discussion of the principles of administrative law that would have applied if the Board's decision had been reviewable. No doubt the court was prepared to strike an attitude of deference in respect of the Board's decision. Jones J. stated:

> Even if this Court had before it the complete record of all the evidence, including the testimony which was before the Board on the appeal hearing, it is clear from the material that this Court does have before it that the considerations which must be brought to bear upon the problem at hand is one which requires great knowledge and expertise in the field. For this reason, a body such as the Municipal Government Board must be accorded some deference with regards to the fact finding process and its ability to deal with the problem at hand.[94]

While it was fair for the court to acknowledge the technical nature of the evidence at issue, it is noteworthy that the court apparently assumed that, since the facts were complex, the Board members possessed expertise. Nowhere, for example, did the court discuss the composition of the Board or the qualifications of its members. Perhaps it goes without saying, but in settling upon a standard of deference for review, there is no reason to assume that a tribunal is specialized merely because difficult evidence is presented before it.

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92 The court stated that "[i]t does not appear that the Municipal Government Board, which functions under the authority of the Municipal Government Act (Alberta), was required to make a transcript of the proceedings a part of the record before this Court on judicial review. It did not do so." *Minburn*, *supra* note 89 at 154.

93 *Ibid.*

94 *Ibid.* at 153.

2. *WESTCOAST ENERGY INC.* v. *PEACE RIVER (REGIONAL DISTRICT)*[95]

a. Facts

A representative of an electoral area within the Peace River Regional District was approached by a resident who inquired about whether the Regional District would consider building a new ice arena in the area. In due course, a committee composed of representatives of various interested communities was organized. Six different sites for the arena were proposed, and an independent consultant was hired to select the best one. When the consultant reported back with his recommendation, two of the communities that had been interested withdrew their support. When this occurred, the boundaries of the local service area were redrawn, and, in the result, the upper two thirds of the redrawn local service area consisted mainly of oil and gas territory with little or no population base that would make use of the proposed arena. Two by-laws were duly passed in recognition of the arena project and the new local service area. Opposition arose, and eventually the petitioner companies sought judicial review of the by-laws and alleged that the by-laws were unreasonable, enacted in excess of jurisdiction, and enacted in bad faith.

b. Decision

Boyd J. was faced with conflicting affidavit evidence as to the circumstances prevailing when the local service area boundaries were redrawn. In the absence of undisputed facts as to the intention of those who redrew the boundaries, Boyd J. chose to resolve the application with regard for the allegation of unreasonableness. In doing so, Boyd J. relied primarily on the decision in *Canadian National Railway* v. *Fraser Fort George*,[96] in which McKenzie J.A. had stated "[i]t is only if a by-law is so unreasonable that no regional district acting reasonably could have passed it that the by-law can be struck down as having exceeded the bounds of the discretion delegated by the statute...."[97]

On the facts of the case, Boyd J. found it easy to conclude that "there can be no reasonable explanation for the inclusion of the upper two-thirds of the local service area, except to draw upon the largest possible oil and gas industry tax base for financing of the project."[98] Boyd J. found that those lands were effectively unassociated with the proposed site of the arena, and more than once emphasized that they were essentially unpopulated. In a telling remark, Boyd J. also noted that, but for the inclusion of the upper two thirds of the local service area, the tax burden on the average homeowner in the remaining area would have to increase by a further 33 percent to pay for the project, the obvious conclusion being that a population base of only 1000 people cannot afford to build a $2.5 million arena. In short, the boundaries of the local service area were gerrymandered so that the project could be paid for, and,

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[95] (1997), 30 B.C.L.R. (3d) 120 (S.C.) [hereinafter *Westcoast* v. *Peace River*].

[96] (1996), 26 B.C.L.R. (3d) 81 (C.A.).

[97] Quoted in *Westcoast* v. *Peace River*, *supra* note 95 at 126.

[98] *Ibid.* at 128.

as a result, the defined area bore no relationship to the population base that would be served by the project.

VIII. ENVIRONMENTAL LAW

A. *R.* v. *NARSING*[99]

1. FACTS

The accused, Narsing, was a drilling supervisor employed by an engineering company. He was hired to supervise the drilling of four wells using sumpless drilling. The second accused, Brennan, was responsible for the operation and control of the sumpless drilling equipment during most of the relevant period. There was hostility between Narsing and the drilling crew. One of the crew members was overheard planning to "set up" Narsing. While drilling the last of the four wells, a large amount of drilling mud was pumped off the wellsite and discovered by a competitor. Narsing denied having authorized the illegal pumping of drilling mud while Brennan admitted responsibility but claimed that it was an accident (he later recanted). Soon after, a member of the drilling crew told government authorities that drilling mud had been pumped off at other wellsites. Inspections found mud in several locations but no widespread dumping. The accused were charged under s. 98(1) of the *EPEA*[100] which provides that "[n]o person shall knowingly release or permit the release into the environment of a substance in an amount, concentration or level or at a rate of release that causes or may cause a significant adverse effect."

2. DECISION

The court held that the evidence against Narsing was unreliable and vague, whereas Brennan's original admission of responsibility was taken as evidence that he likely gave orders to pump the mud off the wellsite. Brennan was convicted on one count.

With respect to the law, the court noted that s. 98(1) of the *EPEA* contains a true *mens rea* offence. The similarly worded offence under s. 98(2) (the only difference between the sections being that s. 98(1) includes the word "knowingly") is an offence of strict liability. The court stated that it was "unaware of any authority that stands for the proposition that a strict liability offence, however similarly worded, may be a lesser and included offence of a mens rea offence. The strategic and policy reasons in terms of a fair trial for the accused for this not to be permissible are obvious."[101]

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99 (1996), 45 Alta. L.R. (3d) 228 (Prov. Ct.) [hereinafter *Narsing*].

100 *Supra* note 48.

101 *Narsing*, *supra* note 99 at 250.

IX. TAX

A. *EXCEL ENERGY INC. V. ALBERTA*[102]

1. FACTS

In 1987, a corporation known as Drummond was granted a mineral lease by Alberta. The lands under the mineral lease were unitized. Also in 1987, Drummond farmed its interest to Excel Energy Ltd., and Excel became entitled to a 15 percent interest in the net revenue from the unit.

In its Alberta corporate tax returns for the 1987 to 1990 taxation years, Excel reported its share of the revenues from the leasehold property as income and claimed a royalty tax credit. Alberta re-assessed Excel to disallow this credit for these years and Excel appealed the matter to the Court of Queen's Bench. The Court of Queen's Bench held that Excel was entitled to claim this credit. Alberta then appealed this issue to the Court of Appeal.

2. DECISION

The Court of Appeal reversed the lower court's ruling and held that Excel was not entitled to claim the royalty tax credit. The court examined the language and purpose of ss. 26 and 26.1 of the *Alberta Corporate Tax Act.*[103] Subsection 26.1(2) of the *ACTA* permits any corporation to claim an Alberta royalty tax credit (an ARTC) if that corporation is required to report Alberta Crown royalty income in its tax return. Subsection 26(1)(c) defines "Alberta Crown royalty" to be any income that must be included in the corporation's income under s. 12(1)(o) of the federal *Income Tax Act.*[104] Finally, s. 12(1)(o) of the *ITA* states, among other things, that a taxpayer must include in its income "any amount ... that ... because of an obligation imposed by statute ... became receivable in the year by ... (i) Her Majesty in right of ... a province as a royalty...." The court had to decide whether the amounts received by Excel in the taxation years in question were received "because of an obligation imposed by statute."

The court found that the statutory provision that imposes the royalty obligation is s. 34 of the *Mines and Minerals Act*[105] which reserves a royalty to Alberta "on any mineral recovered pursuant to an agreement." The court had to determine whether this royalty obligation was imposed upon Excel. Excel argued that "obligation" does not mean a legal obligation imposed on a taxpayer directly (*i.e.* as a personal duty), but rather, it means an obligation that exists in relation to the producing property. The court rejected this argument on the basis that the *ITA* intended to divert petroleum revenue from Alberta to the federal government. Given this purpose, the court found that the *ITA* intended to deem a royalty to be income *in the producer's hands*, even though the

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102 (1997), 196 A.R. 67 (C.A.) [hereinafter *Excel*].

103 R.S.A. 1980, c. A-17 [hereinafter *ACTA*].

104 S.C. 1985, c. 1 (5th Supp.) [hereinafter *ITA*].

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

producer never owns or receives any benefit from the royalty. The *ITA* thus creates a mechanism whereby the producer pays federal tax on the royalty. The ARTC mechanism, in turn, was created to provide the producer with some relief from the federal tax, and to act as a production incentive.

Since only the producer is required to pay federal tax on the royalty, the court held that only the producer, or a person under an immediate obligation to honour the royalty, is entitled to claim the ARTC. And on the facts, the court concluded that Excel — as farmee — was not such a person and thus was not entitled to claim the ARTC for the 1987 to 1990 taxation years.

3. COMMENTS

This case is important because it establishes that any party claiming through the producer cannot directly claim the ARTC. Kerans J.A.'s parting comment is interesting in this regard: "I feel obliged to add that it may well be that, if the producer gains a benefit from the royalty credit, he must share that benefit with revenue interests. That is an issue that arises in the context of the precise relationship between them."[106]

B. *CHEVRON CANADA RESOURCES LTD.* v. *M.N.R.*[107]

1. FACTS

Chevron Canada Resources Ltd. was assessed by the Minister of National Revenue with respect to its 1985 and 1986 taxation years. Chevron filed notices of objection in 1990 and was subsequently reassessed by the minister. In 1992, Chevron appealed the reassessments and raised several issues. The issues raised generally concerned the deductibility of certain types of expenses and the computation of Chevron's resource profits. The minister and Chevron settled some specific issues and the Tax Court of Canada issued a consent judgment to that effect. As required by the consent judgment, the Minister reassessed Chevron on the settled issues. Chevron then filed further notices of objection which raised both new issues and issues that had been raised in the original appeal but that were not resolved by the consent judgment. One of the issues raised in the objection, however, had already been dealt with in the settlement negotiations.

The Tax Court of Canada had to determine whether Chevron could validly raise the issues that it purported to raise in the fresh notice of objection. The relevant provisions of the *ITA* are ss. 165(1) and 165(1.1). These subsections permit a taxpayer to object to an assessment that assesses tax, interest or penalties in accordance with a court order, but this permission exists "only to the extent that the reasons for the objection can reasonably be regarded as relating to a matter that gave rise to the assessment or determination and that was not conclusively determined by the court...." The minister claimed that Chevron's notices of objection were invalid under the *ITA*.

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[106] *Excel*, *supra* note 102 at 72.

[107] [1997] 2 C.T.C. 2624 (T.C.C.).

2. DECISION

The court investigated the purpose of s. 165(1.1) and its role in limiting the taxpayer's right to object. The court stated that while a taxpayer has the right to object to an assessment or reassessment, the taxpayer does not have the right to have the court retry issues that have already been resolved by a court's judgment. The court concluded that any matter that was specifically dealt with in the consent judgment clearly could not be raised in the new notices of objection. However, the court held that the function of s. 165(1.1) goes beyond providing for this outcome since it is merely an application of the *res judicata* principle. Additionally, and at a minimum, s. 165 confers upon a taxpayer the right to object for the purposes of correcting a re-assessment that does not conform with the judgment to which it relates. Finally, with regard to the facts, the court stated that broad issues of expense deductibility and resource-profit calculation were matters that had given rise to the reassessments, such that s. 165(1.1) was satisfied, and that specific issues raised by Chevron had not been resolved by the court in the consent judgment.

3. COMMENTS

It appears that a taxpayer can object for a variety of reasons, including: (1) to correct an assessment that does not conform to a judgment; (2) to raise new issues; and (3) to raise issues which are not new, in that they were raised in previous objections, but which have not been resolved by a court. Of course, the right of objection is not so broad as to permit a taxpayer to object open-endedly to a matter that has already been dealt with in settlement negotiations or in the judgment of a court. Though not specific to the oil and gas industry, this case, therefore, has implications for companies that plan to negotiate with Revenue Canada.

C. *WHEELER* V. *M.N.R.*[108]

1. FACTS

In 1988, Benchmark-One Hydrocarbons Inc. entered into a joint venture agreement with Canadian Futurity Oils Ltd. In that agreement, Futurity agreed to enter into agreements for oil and gas properties in western Canada, and Benchmark agreed to incur Canadian exploration expenses (CEE) in order to acquire interests in the properties of Futurity and third parties. Subsequently, Benchmark, in an offering memorandum, offered flow-through common shares to the public. In that offering memorandum, Benchmark offered to incur CEE equal to the full subscription price of any shares purchased and to renounce CEE in favour of the subscribers. The appellants subscribed for 111,000 shares at a price of $1.00 per share. In 1989, Benchmark incurred expenses of $100,000 in relation to the drilling of a particular well in Alberta. As it turned out, the well was not economically viable. Nevertheless, Benchmark classified these expenses as CEE and allocated this CEE to the appellants in proportion to their share holdingss. The appellants deducted the allocated CEE from their

[108] [1997] 2 C.T.C. 2960 (T.C.C.).

respective incomes in 1988. The Minister of National Revenue disallowed the deductions and claimed that the allocated amounts did not qualify as CEE. The relevant provision of the *ITA* is s. 66.1(6)(ii.1)(A) which provides:

> "Canadian exploration expense" - ... means ...
>
> ...
>
> (ii.1) any expense incurred by [a taxpayer] after May 6, 1987 and in a taxation year of the taxpayer in drilling or completing an oil or gas well in Canada ... if
>
> (A) the well resulted in the discovery of a natural accumulation of petroleum or natural gas and the discovery occurred at any time before six months after the end of the year.

The appellants appealed to the Tax Court of Canada.

2. DECISION

The court discussed the context and background of s. 66.1(6)(a)(ii.1)(A) in detail and held that the *ITA* intentionally omits any reference to production *in commercial quantities* in s. 66.1(6)(a)(ii.1)(A). The section only requires the "discovery" of "a natural accumulation." Since these words are undefined in the *ITA*, the court interpreted the statute with regard for industry usage. In the result, the court concluded that what must be proved is that "oil or gas was found in certain quantities ... and that this well was capable of production."[109] It need not be proved that the well was viable or profitable. On the facts, the court preferred the evidence of the appellants' expert and concluded that the CEE was validly incurred.

D. *NORTHCOR ENERGY LTD.* v. *M.N.R.*[110]

1. FACTS

In 1984, Albert Langard and 304854 Alberta Ltd. (854) established a limited partnership. 854 became the general partner and Langard became the only limited partner. 854's sole shareholder was Exco Energy Ltd. until May 1985, when Langard purchased Exco's shares in 854 and became the sole shareholder of 854.

In October 1984, Exco and the partnership entered into a share subscription agreement whereby the partnership agreed to incur CEE solely as consideration for it being issued preferred shares in Exco. Under the agreement, the partnership agreed that Exco would act as its agent and would incur CEE on its behalf. Once incurred, the CEE was to be allocated to new limited partners in the partnership in proportion to the capital investment of each. The agreement was designed to further a tax plan whereby

[109] *Ibid.* at 2978 (para. 40).
[110] [1997] T.C.J. No. 113 (T.C.C.) (QL).

each limited partner could thereby deduct CEE in excess of that partner's capital investment. The availability of this excess CEE was anticipated on the basis that the Petroleum Incentives Program would fund 80 percent of Exco's eligible exploration expenses.

Exco accumulated approximately $30 million in CEE from October 1984 to early 1985. However, as of October 1985, no new limited partnership units had been sold. In October 1985, Exco was declared bankrupt. The trustee in bankruptcy appreciated that the CEE in Exco had potential value. As a result, the trustee in bankruptcy, the partnership, 854, and Langard executed an agreement whereby Langard agreed to sell new units in the partnership to outside investors as a means of paying down the partnership's debt to Exco. Langard was not successful in this regard. A Northcor Energy Ltd. company then agreed to take over Langard's obligations and to sell partnership units. However, Northcor was also unable to sell any units. As a result, several new agreements were executed just prior to the partnership's fiscal year end, as follows: (1) a Northcor company purchased Langard's limited partnership interest for $100 (Langard's original investment); (2) a Northcor company purchased all of Langard's shares in 854 for $1; and (3) Langard was paid $250,000 for any rights he might have had in respect of commission payments for the sale of partnership units. Following this transaction, Northcor divided up the limited partnership interest into 1,000 equal parts, and the appellant's predecessor company retained 828 of these parts. Accordingly, 82.8 percent of the CEE incurred by Exco was allocated to that predecessor company, and that company purported to deduct some of that CEE from its 1987 income. The Minister of National Revenue disallowed the deduction.

2. DECISION

The Tax Court of Canada concluded, based on the law of agency, that Exco was entitled to be reimbursed by the partnership for the CEE it incurred as agent for the partnership. The court reasoned that the right to deduct CEE is a *chose in action*, and that Exco was entitled to a lien on that intangible property until it was reimbursed. In short, although Exco incurred CEE on behalf of the partnership, the partnership did not own the CEE as property until it was paid for. The court interpreted the contracts between the parties as impliedly supporting this reasoning. According to the court, had the parties been at arm's length, Exco would surely have demanded an express clause to this effect to protect its position as agent. Since Exco was never paid for the CEE it incurred, no CEE was available to the partnership for allocation. More generally, the court stated:

> The concept of using an agency contract to "warehouse" CEE in a limited partnership (portrayed as a drilling fund) during a calendar year pending the arrival of fresh investors at year end may be a very practical piece of business jargon to describe the availability of CEE to potential investors. The common use of such business jargon, however, does not mean that the CEE is or was in the limited partnership at any particular time during the year. The CEE will flow from the exploration company as agent to the limited partnership as principal only when real value (usually money—assigned PIP grants or partners' capital) flowers from the limited partnership to the exploration company. Otherwise, the CEE remains in the exploration company. It is not reasonable to conclude that the principal could

acquire the right to deduct CEE without paying any consideration to the agent for such right. A valid agency agreement, standing alone, will not transfer CEE from the agent to the principal in the absence of any value flowing from the principal to the agent.[111]

3. COMMENTS

This case recognizes that a valid agency agreement, in and of itself, does not justify the transfer of CEE from the agent to the principal. Real value must flow from the principal to the agent, just as it would if the agency agreement were negotiated at arm's length. This is true even if the agency agreement does not expressly require payment by the principal because a court will imply the necessary term. At least at non-arm's length, something cannot be had for nothing.

X. DIRECTORS' LIABILITY

A. *UNITED STATES* V. *IVEY*[112]

1. FACTS

The trial decision in this case was commented upon in last year's edition of this article.[113] The issue under consideration was whether a U.S. judgment, obtained against a corporate director in his personal capacity, was enforceable in the Province of Ontario. The director held a controlling interest in a company which had gone into bankruptcy. The U.S. Environmental Protection Agency had incurred certain environmental clean-up costs with respect to that company's activities and ultimately obtained the U.S. judgment against the director.

The trial judge allowed enforcement of the U.S. judgment in Ontario. That decision was appealed.

2. DECISION

The Ontario Court of Appeal dismissed the appeal.

The appellants raised a number of issues on appeal in addition to certain findings of fact made by the motions judge. The appellants alleged the following errors:

(1) the interpretation, and application to the U.S. environmental legislation, of the "penal, revenue or other public law"[114] test;

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[111] *Ibid.* at para. 34.

[112] (1996), 30 O.R. (3d) 370 (C.A.), application for leave to appeal to the S.C.C. submitted 4 April 1997, [1996] S.C.C.A. No. 582 (QL) [hereinafter *Ivey*].

[113] *Supra* note 30 at 484.

[114] *Ivey*, *supra* note 112 at 372.

(2) the interpretation and application of the *Morguard Trust*[115] test of real and substantial connection between the defendants and the subject matter or place of the U.S. action; and

(3) the conclusion that the American proceedings satisfied the requirements of natural justice.

Each of these alleged errors were disposed of in favour of the respondent, the United States.

XI. FIDUCIARY DUTIES

A. *ROBERT LEMMONS & ASSOCIATES LTD.* v. *GANNON BROS. ENERGY LTD.*[116]

1. FACTS

This is the appeal court decision of the trial judgment reported on by Hope-Ross and McLelland in the 1996 edition of this series.[117] The case arose from a dispute between joint venturers involved in the drilling of two wells subject to a CAPL operating procedure (presumably a 1981 CAPL, although neither the trial judgment nor the Court of Appeal judgment specifically identifies the version). In addition to some rather unusual issues raised on appeal with respect to an alleged bias of the trial judge, the appellant, Gannon, appealed on issues of:

(1) alleged fiduciary relationship;

(2) contract illegality;

(3) payment of engineering fees when an engineer is not authorized to practice; and

(4) calculation of a penalty under clauses 1007(a)(iv) and 903 of the CAPL operating procedure.

A cross-appeal was filed with respect to the application of the CAPL penalty provision.

2. DECISION

The Saskatchewan Court of Appeal upheld the trial judgment excepting the calculation of the penalty. The trial judge had calculated the 300 percent penalty only

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[115] *Morguard Investments Ltd.* v. *De Savoye*, [1990] 3 S.C.R. 1077.

[116] [1997] 2 W.W.R. 688 (Sask. C.A.), additional reasons at [1997] S.J. No. 12 (C.A.) (QL), application for leave to appeal to the S.C.C. submitted 21 March 1997, [1997] S.C.C.A. No. 7 (QL).

[117] *Supra* note 3 at 671.

on the 50 percent share of the completion costs of Robert Lemmons and Associates Ltd. rather than 100 percent of those costs. The Court of Appeal determined that this approach was not proper and that the penalty was to be calculated based on 100 percent of the completion costs.

The cross-appeal, in which Lemmons sought to obtain an interest in a 9-5 well with no penalty payable was dismissed on the basis that Lemmons had indicated in writing that it did not intend to participate in the completion of the well and had stopped payment on a cheque previously provided for Lemmons' share of the completion costs.

3. COMMENTS

This case is of some interest in its discussion of the CAPL provisions dealing with applicable penalties when less than all parties participate in an operation under the agreement. In this case, Lemmons participated in the drilling operation and paid its proportionate share of drilling costs but had elected not to participate in the subsequent completion and equipping of the well. The CAPL provides in clause 903 (alternate A) that:

> If one or more, but not all, of the parties elect to set production casing and attempt to complete the well and the well is completed for the taking of petroleum substances in at least paying quantities, then alternate A below ... shall apply, namely: ... the setting of production casing and the completion shall be considered an independent operation under the provisions of Article X ... as if the independent operation were with respect to a development well.

Clause 1007(a)(iv) provides that:

> If an operation is conducted by a proposing party pursuant to this Article X and the operation is the drilling of a well, then the following shall apply as and between the participating parties and the non-participating parties with respect thereto:
>
> (a) if the well is completed for the production of petroleum substances from one or more formations in which the well is a development well, then with respect to those formations only and the production therefrom, the participating parties shall be entitled to retain possession of the well and all production therefrom until the gross proceeds of such production equals the sum total of:
>
> ...
>
> (iv) 300% of the drilling costs and completion costs of the well as development well.

The Court of Appeal affirmed the trial judgment which found that under these provisions, drilling costs which had been paid should not be included in the calculation of the penalty payable by the party which had not participated in the subsequent completion of the well.

B. *SORREL 1985 LIMITED PARTNERSHIP* V. *SORREL RESOURCES LTD.*[118]

1. FACTS

This case arose out of the receivership of Sorrel Resources Ltd. (Sorrel) in 1986. In this case, the Sorrel 1985 Limited Partnership claimed against two of the individual directors of Sorrel, David Speirs and Louis Mix, alleging that these directors and officers of Sorrel had breached a fiduciary duty to the limited partnership by allowing funds of the limited partnership to be commingled with funds of Sorrel. The action was in part founded on the decision of Lutz J. on 10 February 1987 when he decided, in the course of the receivership action, that funds which had been received by Sorrel pursuant to cash calls, but not yet expended by Sorrel, were trust funds and were required to be returned to the limited partners who had advanced them. The evidence indicated that up until the time of Lutz J.'s decision, no one from the receiver's office or anyone else involved in the receivership considered those unexpended cash call monies to be trust funds. The court summarized the issues to be determined as follows:

> Did the individual defendants have a fiduciary duty to the plaintiff? If so, did they breach that duty in transferring the funds into the general partner's account and allowing those funds to be used for purposes other than a limited partnership business?[119]

2. DECISION

Hawco J. found that, based on the decision of Lutz J. in the receivership action and the fact that Lutz J.'s decision was upheld on appeal, there was clearly a trust or fiduciary relationship as between Sorrel and the limited partners and the limited partnership. There was, accordingly, a breach of the fiduciary duty owed by Sorrel to the limited partnership but that did not necessarily apply to the individual defendant directors and officers. Hawco J. found that there was no fiduciary relationship as between the individual defendants and the limited partnership and that they were not accountable to the limited partnership in any manner in this case. He considered expert evidence from industry accountants who gave evidence that the cash call procedure being used by Sorrel was common in the industry and that the understanding as to the prohibition against commingling of funds applied only prior to the funds being cash called or AFE'd by Sorrel. Once the funds were called upon, the operator, Sorrel, was by industry practice entitled to commingle those funds with its own. The evidence indicated that the decision of Lutz J. to the effect that these were "trust funds" came as a surprise to both the oil and gas industry as well as to the accounting profession at the time and that Sorrel's practice was accepted practice at the time. Therefore, even if the actions did constitute a breach of trust, it was "not fraudulent and dishonest nor morally reprehensible."[120]

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118 (1997), 198 A.R. 55 (Q.B.).

119 *Ibid.* at 62.

120 *Ibid.* at 65.

3. COMMENTS

This decision relies in large part on the understanding of the oil and gas industry and the accounting profession as at 1986 on the question of what constituted trust funds in the hands of an operator. Hawco J. found that the directors' understanding of Sorrel's systems for the cash calling and commingling of funds was consistent with industry practice at the time. In addition, he found no evidence that Sorrel did not intend to pay the accounts for which the funds were cash called and that it would have done so, but for the intervening receivership at the hand of Sociėtė Generale which "came as a complete and disastrous surprise."[121]

C. *TERRA ENERGY LTD. V. KILBORN ENGINEERING ALBERTA LTD.*[122]

1. FACTS

The plaintiff, Terra Energy Ltd., held a licence for a particular process used to extract bitumen from oil sands (the SESA process). Terra obtained the licence so that it could attempt to prove the commercial feasibility of this patented technology.

Between 1974 and 1985, Terra spent substantial government funds on the development and commercialization of the SESA process but did not obtain any commercial success. In 1987, the National Research Council of Canada and the Alberta Oil Sands Technology & Research Authority contributed $500,000 each towards the development and commercialization of the SESA process. Utilizing these funds, Terra hired the defendant, Kilborn Engineering Alberta Ltd., to undertake engineering services on behalf of Terra to assist in developing the process. The defendant, Strand, was a "key" employee of Kilborn on the Terra project. During the time that he was working on the Terra project, Strand discovered a new technology for the extraction of bitumen from the oil sands. The device was called the "strand separator" and formed the heart of a new process known as the counter-current drum separator (CCDS). The CCDS process was subsequently assigned by Strand to Kilborn and patented in late 1990. In 1991, Kilborn entered into an agreement with Fording Coal Ltd., who formed a new company, Bitmen Resources Inc., which presently holds the rights to CCDS. Upon discovering that this CCDS process had been developed and promoted while Kilborn was working on Terra's process, Terra commenced this action. Terra alleged a fiduciary relationship, breach of fiduciary obligations, misuse of confidential information and breach of an implied term of the contract between the parties requiring a duty of loyalty and good faith and avoidance of a conflict of an interest by Kilborn. Terra sought damages, including exemplary and punitive damages as a result of Kilborn's alleged conduct prior to or during the litigation.

[121] *Ibid.*

[122] (1997), 198 A.R. 241 (Q.B.).

2. DECISION

Cairns J. found that Kilborn had placed itself in a position of conflict of interest and that it thereby breached an implied term of the contract between Terra and Kilborn, that being an implied term requiring loyalty and good faith. He did not find a fiduciary relationship existing between Terra and Kilborn in a traditional sense, either arising on the facts or by statute. Cairns J. found that the CCDS process arose from Strand's personal experience and that it "did not emanate from confidential information of Terra conveyed to Kilborn and reviewed by Strand in connection with the Terra project."[123] He found that the SESA and CCDS processes, while unique as between themselves, had an identical purpose and that they were competitive in a specified and limited market. Terra and Kilborn were targeting precisely the same prospective customers, Suncor Inc. and Syncrude Canada Ltd..

Cairns J. found, in conclusion, that while Terra was not entitled to the strict equitable remedies which could be imposed in a case where a fiduciary relationship was found, Terra was entitled to damages based on the breach of Kilborn's contractual duties of loyalty, good faith and avoidance of conflict of interest. As this case was apparently split to deal with the liability issue in advance of the remedies issues, Cairns J.'s decisions with respect to those issues and with respect to the punitive damages were reserved pending further evidence and argument.

3. COMMENTS

This is a very lengthy decision which examines in great detail a multitude of facts particular to this case. As Cairns J. points out, an analysis of whether a fiduciary relationship existed in this case required a meticulous examination of the facts. The key finding by Cairns J. appears to be the fact that there was no imbalance of power between the parties and no particular discretion or power vested in Kilborn which it could have unilaterally exercised to adversely affect Terra or to benefit itself. In addition, he noted that the relationship was not one in which Kilborn was providing an "advisory" function, but rather providing professional services, not advisory in nature.

Cairns J. also found, in the course of reviewing this issue, that the professional engineer-client relationship which does carry with it a number of duties imposed by the Association of Professional Engineers, Geologists and Geophysicists of Alberta (APEGGA) *Code of Ethics* does not necessarily place a fiduciary duty on the professional engineer. The statutory relationship created by the *Engineering, Geological and Geophysical Professions Act*[124] and by the APEGGA *Code of Ethics* does not, in and of itself, create a fiduciary obligation if the factual context of a particular relationship would not otherwise meet the test.

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[123] *Ibid.* at 384.

[124] S.A. 1981, c. E-11.1.

XII. CIVIL PROCEDURE

A. SOLICITOR-CLIENT PRIVILEGE

1. *ARCHEAN ENERGY LTD.* V. *M.N.R.*[125]

a. Facts

Applications were brought pursuant to s. 232(4) of the *ITA*[126] to determine whether documents in the possession of a law firm were the subject of solicitor-client privilege. Section 232(4) permits an inquiry into privilege where documents have been seized and placed into custody. Some of the documents in question related to a "butterfly transaction" involving nineteen different corporations. One of those corporations, Archean Energy Ltd., claimed privilege with respect to the relevant documents, but that claim was resisted. As Archean was not incorporated until October 1993, and the transactions which were of interest to Revenue Canada occurred between December 1991 and 19 April 1994, the Minister of National Revenue argued that any claim of privilege could only be asserted by one or more of the corporations that existed prior to 1993 and that had been directly involved in transactions at that time. Moreover, the minister argued that no such claim by another corporation could be made as of the application date, because the *ITA* requires such claims to be made within fourteen days of the seizure of the documents.

In a related application, Titleist Energy Inc. claimed privilege with respect to several legal opinions that it received as part of a purchase and sale transaction with related companies. The minister resisted that claim on the basis that the interests of Titleist as purchaser were adverse to those of the other companies as vendors, such that the claim of privilege had been waived.

b. Decision

With respect to Archean's claim, McMahon J. noted that it would have been virtually impossible for the law firm to identify, with respect to each individual document, which of the many companies involved in the butterfly transaction could properly claim privilege. While the court thought it might have been prudent for the law firm to name as many companies as could be recalled, it was sufficient for Archean to claim privilege in the circumstances. The claims of others could still be protected after due consideration and review, notwithstanding that the others did not independently claim privilege as described in the statute.

With respect to Titleist's claim, McMahon J. concluded that parties to a commercial transaction are not adverse in interest the way that parties to litigation are. McMahon J. stated in part that "parties to a commercial transaction have a common interest in seeing

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125 [1997] A.J. No. 347 (Q.B.) (QL).

126 *Supra* note 104.

the deal done. That is particularly so where the companies are related by some common shareholders or management as is said to be the case here."[127]

B. SOLICITOR-CLIENT CONFLICTS OF INTEREST

1. *BOW VALLEY ENERGY INC.* V. *SAN DIEGO GAS & ELECTRIC CO.*[128]

a. Facts

San Diego Gas & Electric Co. and Bow Valley Energy Inc. were represented by separate counsel with respect to a joint operating agreement and a gas purchase agreement they negotiated. The operating agreement contemplated that they would also have separate counsel with respect to the necessary application to the NEB. In fact, the same law firm acted for both parties with respect to that application.

A dispute arose regarding the gas purchase agreement. The law firm that had previously acted for both parties with respect to the NEB application continued to act for San Diego in the lawsuit that resulted. A chambers judge determined that the law firm was disqualified from continuing to act; San Diego appealed.

b. Decision

San Diego argued that when a single counsel acts for two parties to a transaction, there is no confidence between them and all information must be produced. The Court of Appeal did not find it necessary to explore the details of the information that passed between the parties originally. Instead, the Court of Appeal stated simply:

> In our view, to allow a law firm to act for both parties and then elect to act for one party against another in a closely related matter (here the same matter) is to create at least an appearance of unfairness and impropriety which is unacceptable.[129]

The appeal from the chambers decision was dismissed.

c. Comments

The *Alberta Code of Professional Conduct* contains the following well-known rule: "Except with the consent of the client or former client, a lawyer must not act against a client or former client if the lawyer has confidential information that could be used to that person's disadvantage in the new representation."[130] Does the Court of Appeal's decision imply that, even if a lawyer possesses no confidential information about a former client, the "appearance of unfairness and impropriety which is unacceptable" will always result if the former client refuses to consent to the lawyer's

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[127] *Supra* note 125 at para. 30.
[128] (1996), 181 A.R. 261 (C.A.).
[129] *Ibid.* at 263.
[130] Chapter 6, Rule 3.

new representation? And if consent is not always required, why did the court not examine whether confidential information was possessed by the law firm?

2. *CANADA SOUTHERN PETROLEUM LTD.* v. *AMOCO CANADA PETROLEUM CO.*[131]

a. Facts

A complicated dispute arose concerning the development and marketing of gas from a Yukon gas field. A trial to resolve the dispute was scheduled to last a full year and began in September 1996. Three weeks into the trial, it was alleged that the Calgary office of the firm acting for one of the defendants, Amoco Canada Petroleum, was in a conflict of interest position. That firm brought an application to be permitted to continue as counsel.

The conflict allegation arose from the following facts. A lawyer named Hutzel was employed by the general counsel for Canada Southern Petroleum Ltd. (one of the plaintiffs). He worked in that capacity for approximately twenty-five years. In 1995, he joined the Toronto office of the Calgary law firm acting for Amoco. Hutzel clearly possessed confidential information with respect to the litigation in question, most of which he had acquired from an American attorney who was also counsel to Canada Southern. When Hutzel arrived at his new firm, he did not speak with other members of the firm in respect of his knowledge about the Canada Southern litigation until such time as he was contacted and told not to do so. The problems associated with Hutzel's move were, in fact, first detected by a lawyer in the Calgary office of the law firm during pre-trial preparations, at which time various measures were instituted in an effort to prevent confidential information from being disclosed. Shortly after his arrival at the new firm, Hutzel did, however, discuss the litigation with the American attorney (who was actively involved in the litigation), and Hutzel advised him that he, Hutzel, would have no contact with those in the Calgary office who were acting for Amoco.

The chambers judge permitted the Calgary law firm to continue acting, and Canada Southern appealed.

b. Decision

The chambers judgment was upheld. Since Canada Southern had failed to provide evidence from the American attorney, the chambers judge was entitled to infer that no real prejudice or mischief was anticipated by that counsel with respect to Hutzel's move to the new law firm. The new rules in the *Alberta Code of Professional Conduct* dealing with firm-to-firm movement by lawyers were applicable in the circumstances, and *Martin* v. *Gray*[132] was to be interpreted having regard to these new rules.[133] The

131 (1997), 193 A.R. 241 (C.A.), aff'g (1996), 195 A.R. 1 (Q.B.), leave to appeal to S.C.C. dismissed [1997] S.C.C.A. No. 162 (QL).

132 *MacDonald Estate* v. *Martin*, [1990] 3 S.C.R. 1235 [hereinafter *Martin* v. *Gray*].

case could be distinguished from *Martin* v. *Gray* in that: (1) law societies have now enacted rules to be considered in such circumstances; (2) Hutzel did not work directly on the litigation in question; (3) Hutzel worked in a different city than the lawyers acting for Amoco; (4) the law firm in question took steps to ensure that confidential information was not disclosed once the danger was perceived; (5) Hutzel had advised the American attorney for Canada Southern of his new position; (6) the matter had proceeded to trial; and (7) third parties to the litigation would be greatly prejudiced by a decision that the law firm could no longer act (examples of this third-party prejudice noted by the court include the consequence of adjourning the complex litigation, and the fact that many expert reports would have to be reconsidered with the passage of time). The Court of Appeal stated that, although the law firm's efforts to control disclosure were *ex post facto* measures, such measures are not always inadequate — the test will be fact-specific. In the circumstances, the law firm could continue to act.

c. Comments

Although the Court of Appeal emphasized many different facts in its judgment, two facts may have been determinative. First, the Court emphasized that "representatives of the client, [Canada Southern], had no concerns about Hutzel's move to BENNETT JONES VERCHERE."[134] Given this fact, undertakings by the lawyers regarding the security of the confidential information possessed by Hutzel had a persuasive value they might not have had otherwise. Secondly, Hutzel was physically far-removed from those lawyers in his firm who were representing Amoco. Again, this fact helps minimize concerns that might otherwise be present about the appearance of confidentiality.

Of course, the best way to avoid such problems is through early detection. Many applications based upon a perceived conflict of interest are brought primarily for their strategic value. For this reason if for no other, all clients, but particularly clients involved in major litigation, should be concerned about whether these potential pitfalls are screened out. When a new lawyer joins the firm, as a partner with clients or merely as an associate, what steps are taken to identify the resulting conflicts problems? As the Court of Appeal observed in this case, it would have been preferable if the law firm in question "had some mechanism in place for determining the existence of this conflict at an earlier stage."[135] An application by the plaintiff for leave to appeal to the Supreme Court of Canada was dismissed.[136]

[133] One consequence of this conclusion is that Rule 4 of Chapter 6, rather than Rule 3, applies in respect of such transfers. What this means is that a client need not consent to a firm's representation where the potential conflict results from a firm-to-firm transfer, the way that a client must usually consent if a lawyer (or law firm) proposes to act directly against a former client.

[134] *Martin* v. *Gray*, *supra* note 132 at 284.

[135] *Ibid.*

[136] [1997] S.C.C.A. No. 162 (QL).

C. *FORUM NON CONVENIENS*

1. *ENCAL ENERGY LTD.* v. *NUMAC ENERGY INC.*[137]

a. Facts

The defendant was the owner and operator of two petroleum and natural gas fields in British Columbia. By agreement, the plaintiff had an option (on an annual basis) to take the gas production from either field in kind or to appoint the defendant to market that gas on the plaintiff's behalf. After appointing the defendant to market the gas for a number of years, the plaintiff notified the defendant that it would take in kind its working-interest share of the gas production. The defendant, however, informed the plaintiff that it could make this election only if it assumed a third-party transportation contract that the defendant had entered into with respect to the gas. The plaintiff refused to do so, and therefore did not take its share in kind as planned. As a result, the plaintiff sued for breach of contract and for conversion.

The defendant applied for a declaration that Alberta would be the more convenient forum for trial. The field agreements in question made Alberta the proper law of the contract, and purported to give the Alberta courts exclusive jurisdiction to interpret the agreements.

b. Decision

The court held that Alberta was the more convenient forum and stayed the proceedings. Whereas it was argued that British Columbia was a better forum because real property interests in that province were affected by the pleadings, the court responded that only gas *production* was in dispute, and that, once produced, gas ceases to be realty and becomes personalty. Other factors then swayed the balance in favour of Alberta: all of the parties and most of the witnesses were in Alberta; the documents were in Alberta; Alberta law applied to the contracts; and (having regard to the presence of the exclusive-jurisdiction clause as merely a relevant factor — a point conceded by the defendant), Alberta had the more real and substantial connection to the action.

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[137] [1996] B.C.T. No. 198 (QL).

D. PRESERVATION OF PROPERTY

1. *DSWK HOLDINGS LTD.* V. *MUTUAL OIL & GAS LTD.*[138]

a. Facts

The respondent owned a 90 percent interest in an oil field, but the appellant, who owned the other 10 percent, was its operator. In chambers, the respondent obtained a declaration that it would henceforth be the operator of the field. The order was obtained as a means of preserving property before trial. The appellant appealed.

b. Decision

The majority held that there may be jurisdiction, in a proper case (*e.g.*, where there is waste), to grant an interim injunction for the purpose of preserving property. However, the respondent's effort to prove that it could operate the field more efficiently was not a sufficient reason for interfering in the absence of urgency. The majority noted that many issues remained undecided — such as the respondent's potential insolvency — that might affect the question of whether the defendant should act as operator. The chambers declaration was accordingly set aside.

In dissent, McClung J.A. thought that the respondent's 90 percent ownership position was, by itself, sufficient reason to favour the declaration made by the chambers judge. McClung J.A. suggested that "[t]he gas that must be produced to pay for the unnecessary costs of the operation is sufficient to meet the requirement of demonstrating that there is a need for preservation of property."[139]

2. *CARSON WELDING & MAINTENANCE LTD.* V. *HERC OIL CORP.*[140]

a. Facts

In the context of builders' lien actions, the applicants applied for an order preserving certain proceeds of oil production from properties operated by Williston Wildcatters Oil Corporation (WWOC). Approximately 408 builders' liens were filed totalling some $3.8 million. The main respondents in this application held interests in one or more of the oil wells which were the subject of the liens.

WWOC had experienced financial difficulties. The respondent, Herc Oil Corp., was formed for the purpose of making a proposal to restructure the assets and liabilities of WWOC to its creditors. Herc obtained an order from the Alberta bankruptcy court staying proceedings and approving a plan of arrangement and compromise on 11 May 1996. The applicants' concern was that, unless the production proceeds from the various lands were paid into Court pending resolution of the builders' liens, the builders' lien

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138 (12 June 1996), Calgary 96/14567 (C.A.), [1996] A.J. No. 582 (QL).

139 *Ibid.* at para. 9.

140 [1997] 1 W.W.R. 268 (Sask. Q.B.).

claimants might suffer irreparable harm and be unable to recover the full amount of their liens. As an interim measure, the applicants had received an *ex parte* order directing payment of revenues to an escrow agent until the hearing of the application. The parties were all agreed that the applicable principles were those that would apply to an application for injunctive relief, specifically a mandatory injunction.

b. Decision

The court confirmed the generally recognized tripartite test of:

(1) a *prima facie* case;

(2) a balance of convenience; and

(3) irreparable harm, all in favour of the applicant.

MacPherson J. denied the application for a number of reasons:

(1) he had some misgivings as to whether the material filed in support of the application was sufficient to support a *prima facie* case;

(2) the plaintiffs did not establish a very strong probability on the facts that they would accrue grave damage in the future;

(3) the risk of damage to the respondents if the order was granted was far greater than the risk to the applicants if the order was not granted as the properties could not be operated without sufficient funds to do so;

(4) if the order was granted there was a significant risk that the Saskatchewan Department of Energy and Mines could shut down Herc's operations if it failed to meet any of its environmental obligations;

(5) the liens had not been proved as yet;

(6) damages would be a sufficient or adequate remedy if the damage did occur, *i.e.* no demonstrable irreparable harm; and

(7) The balance of convenience did not favour the applicants on these facts.

c. Comments

This case is interesting in that the court recognized the need, from a practice perspective, to keep the property operating for the benefit of the working interest owners in circumstances where the lien claimants had not as yet proven their entitlement to any monies.