



Burnet,
Duckworth
& Palmer LLP
Law Firm

ENERGY

M A T T E R S

JUNE 2007

When Negotiations Become a Contract Perhaps Sooner Than You'd Think

by Catherine B. Reyes, Student-at-Law



INTRODUCTION

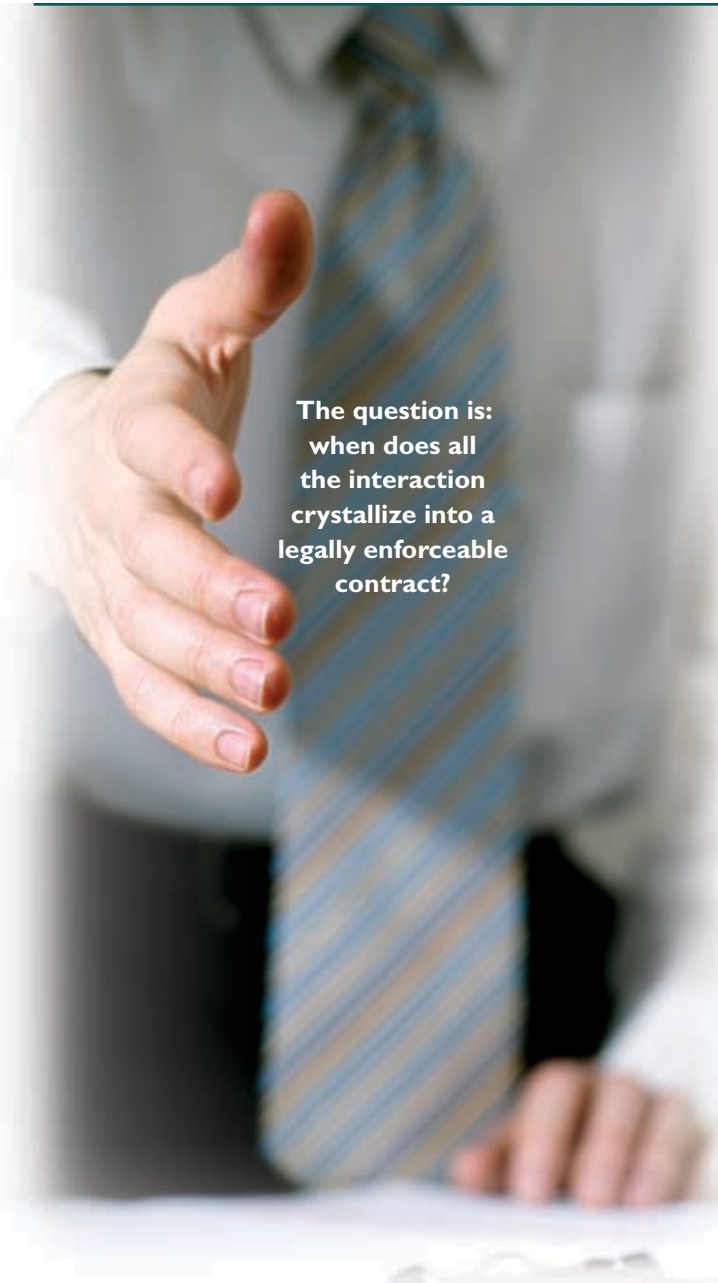
During the course of business negotiations, ideas are bandied about, strategies are formulated, promises are made and hands are shaken. These communications are typically viewed as part and parcel of deal making, and may or may not culminate in a final binding agreement. The question is:

when does all the interaction crystallize into a legally enforceable contract? Most would say that this occurs at the moment a written contract is executed by all parties. While the law does not require that contracts be written (except in certain circumstances), one would not expect a multi-million dollar deal to be sealed by mere discussions and a handshake.

– continued on page 1

in this issue:

When Negotiations Become a Contract – Perhaps Sooner Than You'd Think.....	Front Cover
What We've Been Up To	3
The EUB Rules on the Right to Right to Produce Coal Bed Methane.....	4
Good Faith Negotiations – Does Such a Duty Exist?.....	6
Taking Security Interests in IOGC Leases	8
Energy, Energy Litigation, Energy Regulatory	9
Energy Lawyers Contact Information	Back Cover



**The question is:
when does all
the interaction
crystallize into a
legally enforceable
contract?**

A recent decision of the Alberta Court of Queen's Bench should serve as a warning to business people that a written contract in the traditional sense of the word may not be a prerequisite to the finding of legally enforceable obligations; even where such obligations are of the multi-million dollar variety. In *Klemke Mining Corporation v. Shell Canada Resources Limited, Chevron Resources Limited, Western Oil Sands Inc. and Albian Sands Energy Inc.*¹ ("Klemke"), Madame Justice L.J. Smith considered a situation in which a company claimed that a contract had been made, notwithstanding the lack of a formal written agreement. The alleged contract was one by which the plaintiff, Klemke Mining Corporation ("KMC"), had agreed to provide certain mining and consulting work for a joint venture operating a mining project in the Athabasca oil sands.

FACTS

From early on in the proposed project, KMC had indicated their interest in participating. They contributed to a couple of feasibility studies concerning the site and had several discussions with one of the joint venturers, Shell Canada Limited (Shell), about securing a mine development contract for the project. Justice Smith accepted KMC's contention that at a meeting between Shell's representative and KMC's representative on June 25, 1999, Shell offered a mining contract to KMC subject to two preconditions: a) that KMC had "skin in the game", meaning that KMC was required to make an investment in the project so that its interests were aligned with the success of the project; and b) that a project must exist. An agenda for this meeting had been prepared by KMC, which was revised at Shell's request and sent to KMC on the 29th of June. In the cover letter, KMC's representative indicated KMC's intent to invest in Newco (a corporation which would become one of the joint venturers) thus meeting the first condition precedent and confirmed KMC's request to be involved in the mine development work, meeting the second condition precedent. In a phone call between KMC and Shell's representative on June 30th, Shell indicated that KMC had "hit the nail on the head" in its redraft of the agenda. Justice Smith held that the June 29th documents (the letter and attached agenda) corroborated KMC's assertion that there was an agreement reached on June 25th that KMC would provide the initial mine work at a price determined by a benchmarking mechanism.

On November 15th, 1999, a term sheet prepared by an employee of Shell was sent to KMC by an employee of Western Oil Sands Inc. ("Western"), another participant in the joint venture, which did not mention the contract mining work. KMC sent a mark-up of the term sheet back to the employee of Western. On December 10th, 1999 Western sent a revised letter from Albian Sands Energy Inc. ("Albian"), another joint venture participant, and a revised term sheet to KMC containing reference to the mining work. Justice Smith refers to this letter and term sheet as a Memorialization. On December 14th, 1999, KMC signed and returned the Memorialization. The Memorialization was never executed by Shell and at subsequent meetings of the joint venture parties, it was decided that a questionnaire/score sheet would be sent out to all contractor companies expressing an interest in doing mining work on the project. KMC was informed on March 24, 2000 that the initial mining work was awarded to KMC's competitor, "North American". KMC sued for lost mining and consulting work arising from the deal they believed had been struck.

ISSUES CONSIDERED

Although she admits in her decision that "[t]his is largely a fact driven case" and it appears that the case turned in large part on the credibility of the witnesses, Justice Smith's reasoning in *Klemke* provides valuable insight into: (i) how courts determine whether a contract has come into existence; (ii) the clarity required to create conditions precedent to a contract; (iii) the factors relevant in determining one's authority to bind a party to a contract; and (iv) what satisfies the Statute of Frauds' requirement for a written contract. Each of these points will be examined briefly in this article.

(i) Was there a contract?

The first issue that Justice Smith addressed in *Klemke* was whether a contract had been formed between the parties. In making this determination, she looked to whether there had been a meeting of the minds, which requires an examination of whether the parties intended to contract and whether the terms of the agreement were laid out with a reasonable degree of certainty. Justice Smith concluded that a “reasonable observer with all of the facts would be convinced of Shell’s intention to contract on June 25 and following.” In reaching this conclusion, she pointed to the long relationship between the parties, the fact the Shell had had numerous occasions to deny the existence of a contract and failed to do so, the preparation by the defendants of the December 10 Memorialization and the terminology used in the cover letter to the Memorialization which included phrases such as “Albian and KMC agree to the following...”

Justice Smith acknowledged that there was no formal contract but found that the June 25th meeting of the minds, evidenced by the June 29th documents, the June 30th phone call, and the December 10th Memorialization were sufficient to amount to a binding agreement. She rejected the defendant’s assertion that the Memorialization was merely an agreement to agree, which is not enforceable. The conduct of the parties, she believed, pointed to the conclusion that “the anticipation of a formal agreement was merely anticipation of a more formal reflection of the agreement already necessarily entered into.”

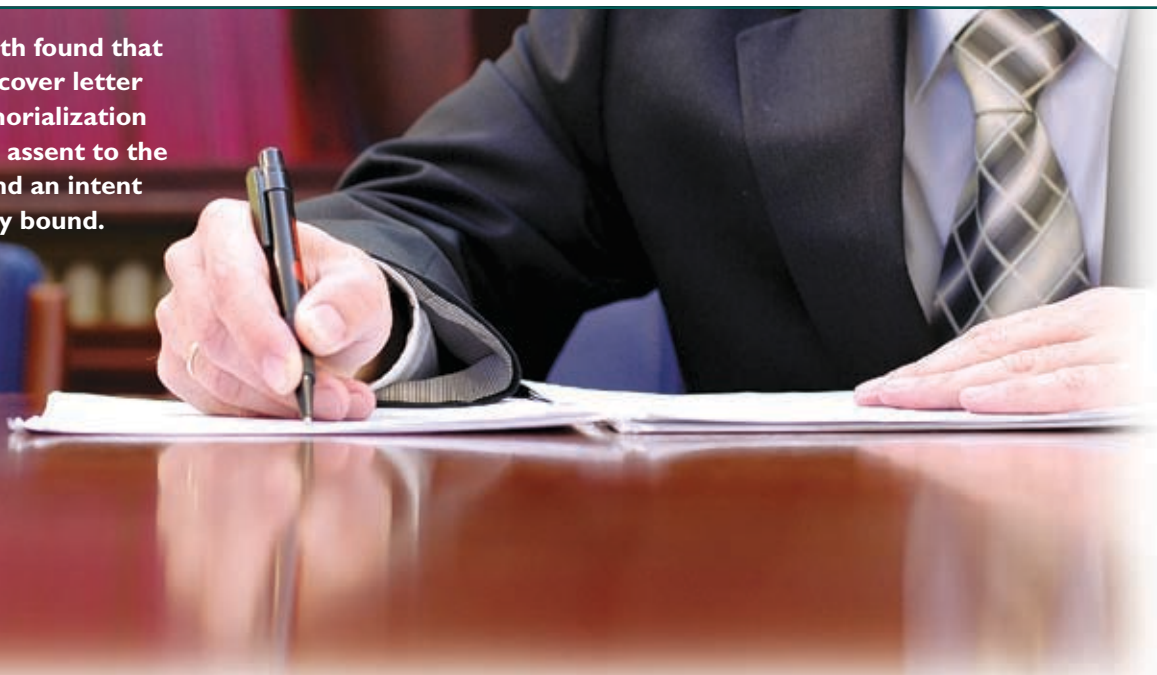
As to submission by the parties to the joint venture that intention to contract could not be inferred since the documents were not signed, Justice Smith found that the signed cover letter of the Memorialization manifested assent to the contents and an intent to be legally bound. Even if this cover letter had not been signed, she points to the words and conduct of the representative of Shell following the creation of the June 29th documents as evidence of his intent to bind the defendants.

Justice Smith then went on to consider whether the terms of the Agreement were sufficiently clear, unambiguous and complete to conclude that the parties had come to a meeting of the minds. The ultimate price had not been agreed to but Justice Smith determined that “in this factual matrix, an ultimate price was not an essential term” because the “parties provided an effective mechanism for determining price.” What was essential was how the price was to be determined. Justice Smith found that the parties had agreed to competitive benchmarking as the pricing mechanism.

(ii) Was there sufficient clarity to create conditions precedent to the contract?

Justice Smith rejected the defendants’ assertion that the approval of the Executive Committee of Albian was a condition precedent to the agreement. KMC had never been informed of such alleged condition and Shell’s representative was not concerned with Executive Committee approval until he was provided with the Memorialization. Justice Smith also rejected a claim that a further condition precedent was that KMC pass a performance review on a project it was working on at the time in relation to the Muskeg River Oil Sands Project (“MRC”). The defendants alleged that this condition was evident in the wording on the term sheet that read: “...provided that Albian is satisfied that KMC will provide the *required work* at a cost that is approximately equal...” Justice Smith held that this reading of the words was “far outside” what the words suggested and not in line with the remainder of the evidence. In the event that she was wrong on this conclusion, Justice Smith examined whether KMC’s performance on the MRC was satisfactory. She concluded that the plaintiffs’ had shown that the problems with performance on the MRC were not caused by lack of capability of KMC. Rather, the problems were largely the result of volumes that were far in excess of estimates in the contract, waste disposal areas and reclamation sites that were too small, cut/fill balances at the plant site that did not exist and fill that was in short supply.

Justice Smith found that the signed cover letter of the Memorialization manifested assent to the contents and an intent to be legally bound.



(iii) What factors are relevant in determining one's authority to bind a party to a contract?

Western's employee signed the cover letter to the December 10th Memorialization while he was an employee of Western on secondment to Shell. Justice Smith indicated that there was no issue as to whether Western could bind the other joint venture participants. Since "Western, as a joint venturer with Shell and Chevron, shared a community of interest in which each was both principal and agent of the other...[they] had the right and authority to bind the others to the Agreement as it was Memorialized." The question, according to Justice Smith, was whether Western's employee had the authority to enter into the contract on behalf of Western or other joint venture participants, or if KMC was entitled to presume that he did. Justice Smith found that although Western's employee was not given the authority by Shell to manage contracts, Shell represented that he had the authority to bind the defendants. Justice Smith cited case law that indicates that an agent may act outside of his actual authority if the agent is acting with ostensible or apparent authority. The apparent authority of Western to contract on behalf of the joint venture parties was demonstrated by witnesses on both sides who provided evidence that they believed Western's employee was the "person in charge of contracts." Shell had instructed Western's employee to draft an agreement for KMC and Shell had actual authority to enter into such agreements. Justice Smith concluded that KMC was entitled to presume that the signature of the Western employee on the agreement was binding on the joint venture.

(iv) What satisfies the Statute of Fraud's requirement of a "written" contract?

A final defence argument that was addressed by Justice Smith was that the *Statute of Frauds* applied since this was a contract for which performance was to last more than a year. Such contract must be in writing and signed by the party to be charged. Justice Smith addressed this concern by indicating that the December 10th Memorialization was sufficient to satisfy the *Statute*. Since the defendants' agent signed the cover letter and the documents were intended to be read together (as evidenced by the language of the cover letter and the history of their development), all of the essential terms were contained in the

Memorialization. Further, Justice Smith pointed to case law that shows that there is no requirement that all of the documents that form a memorandum of agreement be signed. The signature on the cover sheet of the Memorialization was seen as an assent by the defendants of the contents of the entire package of documents.

CONCLUSION

In short, Justice Smith found the existence of an agreement amongst communication that some might have thought were merely negotiations or agreements to agree. She refused to imply terms providing for the prior approval of the Executive Committee of Albion and requiring that the plaintiffs' demonstrate competence in their project that was underway at the time at the Muskeg River oil sands. She found that any one party to a joint venture can bind the others and an agent may bind a party notwithstanding lack of authority to do so if such agent is acting with apparent authority. Finally, she found that a term sheet and a signed cover letter could satisfy the writing requirement of the *Statute of Frauds*. Damages were assessed for lost consulting services and mining work totalling approximately \$22 million.

The most important lesson to be gleaned from *Klemke* is that during negotiations, parties should make it clear that documents are for discussion purposes only and should refrain from making oral assertions that would lead a party to prematurely believe that a final binding agreement has been reached. Further, careful notes should be taken of all interactions so that memories can be refreshed should disagreements arise as to the existence or terms of agreements. Justice Smith admitted to being more inclined to believe the KMC's witnesses since they had more detailed and careful notes and appeared to better recollect the events. Finally care should be taken to ensure that individuals without authority to bind the joint venture to agreements are not held out as having such authority. *Klemke* demonstrates that binding contractual obligations can be found notwithstanding the absence of a formal written contract.

Footnotes

¹ 2007 ABQB 176

What We've Been Up To

John Lowe represented Canpar Holdings Ltd. in the recent AEUB proceedings resulting in Decision 2007-024, which determined that the natural gas owner and not the coal owner is entitled to produce coal bed methane.

BD&P hosted a Construction Seminar for clients on May 4, 2007 "From the Ground Up – A Day in the Construction Trench with BD&P".

Jody Wivcharuk is a Director-at-Large of the Petroleum Joint Venture Association.

Alicia Quesnel is Past President of the Canadian Petroleum Law Foundation ("CPLF").

Carolyn Wright is currently a Director of the CPLF, a member of the Organizing Committee for the CPLF Jasper Conference and an executive member of the Canadian Bar Association ("CBA") Natural Resources Section.

Arnie Olyan is Chair of the Southern Alberta Construction Subsection of the CBA.

Morella de Castro is Vice Chair of the International Business Law Section of the CBA.

INTRODUCTION

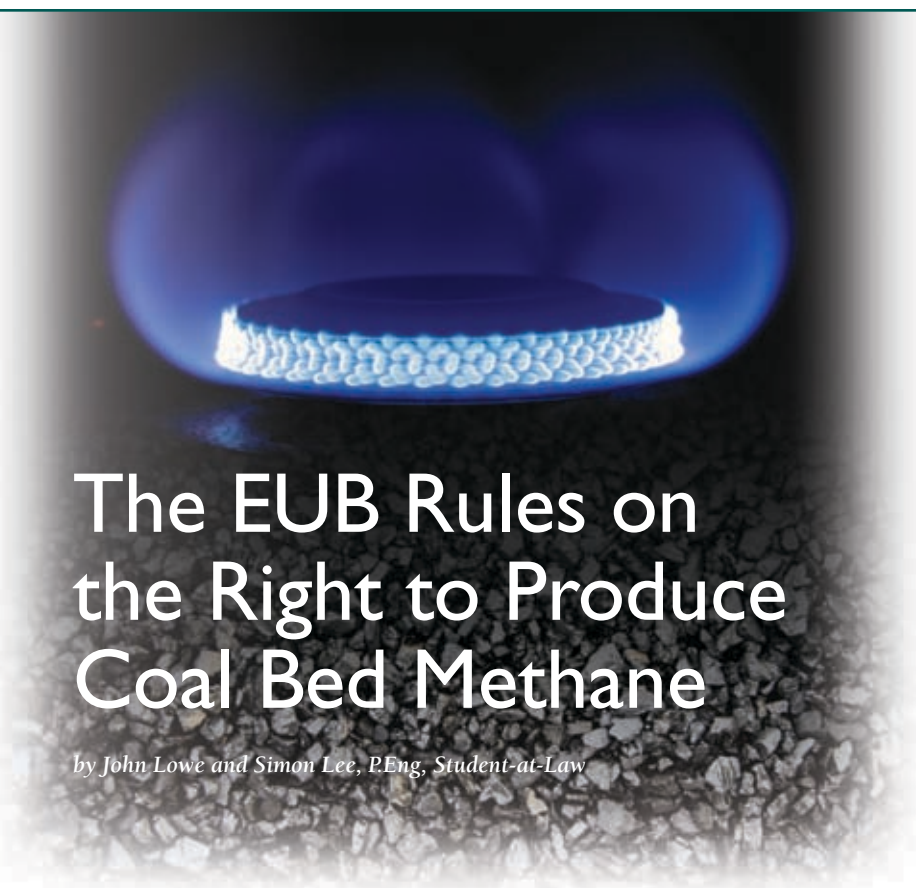
On March 31, 2007 Neil McCrank retired after almost nine years of service as Chair of the Alberta Energy and Utilities Board. One of his last acts as Chair was to release Decision 2007-024 (the “Decision”), the Board’s ruling on ownership of coal bed methane. The Decision ruled that the natural gas owner, not the coal owner, has the right to produce coal bed methane for the purposes of EUB licensing requirements. While ultimate authority to make binding decisions of ownership for all purposes resides with the courts, the Decision clears up uncertainty and paves the way for development of the resource in accordance with the ruling of an expert, quasi-judicial tribunal.

BACKGROUND

Coal bed methane, also known as CBM or natural gas from coal, is primarily methane gas associated with coal seams and is chemically indistinguishable from “conventional” natural gas widely found and exploited in Alberta. Coal seams are thin layers of coal interlaid with other rocks such as siltstones, shales and sandstones. The CBM is associated with the coal in three ways. Some CBM may be contained in voids and spaces within the coal seam, so that the coal simply acts as a “container” in which the gas is stored. Alternately, CBM can be “adsorbed” (chemically attached or bonded) to the surface of the coal or dissolved in water or hydrocarbon liquids present within the coal seams.

It has long been established in Alberta that on crown lands, the natural gas lessee may produce CBM. But prior to Decision 2007-024, there was uncertainty over who had the right to produce CBM from freehold lands: the owner of the coal or the owner of natural gas. In Alberta, freehold “split title” is common.

When title is split, different minerals and hydrocarbons (in this case, natural gas and coal) are owned by different parties. If CBM is considered to be “natural gas”, the natural gas owner holds the right to produce it. On the other hand, if CBM is “coal”, the coal owner holds the right to produce it. Increasingly, the uncertainty over who owned CBM on freehold lands became a barrier to



The EUB Rules on the Right to Produce Coal Bed Methane

by John Lowe and Simon Lee, P.Eng, Student-at-Law

development of the resource. Given that the Board has estimated that CBM will constitute 16% of all marketable gas produced in Alberta by 2016¹, the issue was important to the resource owners and the Province.

THE DISPUTE

Freehold title in petroleum, natural gas, coal, and minerals was originally granted in 1670 to the Company of Gentlemen Adventurers Trading into Hudson’s Bay. Other grants of freehold title were made in the 19th Century to the Railway Companies. These original grantees and their successors in title held the freehold rights to *all* the mines and minerals under the lands in question. However, later transactions, from the early 1900s to 1982, severed the mineral estates, creating split title whereby different parties held the rights to different mines and minerals and hydrocarbons.

Through this historical title, various parties, including Bearspaw Petroleum Ltd., Devon Canada Corporation and Fairborne Energy Ltd. obtained the rights to produce the natural gas on certain lands. In 2005 and 2006, the EUB issued well licence approvals

to these natural gas holders to drill and produce CBM in the Clive, Ewing Lake, Stettler, and Wimborne Fields of Alberta. However, the coal rights on these same lands were held by the Carbon Development Corporation and Encana Corporation. The coal owners objected, claiming that as owners of the coal rights, they were entitled to produce CBM. The EUB granted the coal owners a review to determine whether the well licences were properly issued.

The Board chose to have a full public hearing with all interested parties, including participation by expert technical and legal witnesses, to assist the Board in making a determination. As the hearing developed, two key issues emerged. First, the Board had to decide whether it could make a determination of legal entitlement or leave the matter to be determined by a court of law or by private agreement. Second, if the Board had jurisdiction to make a determination of entitlement, it had to decide whether the natural gas owner or the coal owner is entitled to produce CBM. Mr. McCrank is trained as a lawyer and an engineer. His

expertise, and the industry experience of his fellow Panel Members Berg and Langlo, allowed the Board to evaluate and weigh the competing claims of the rival groups on the science of coal, the application of the common law and the statutory framework.

THE BOARD'S JURISDICTION TO DETERMINE ENTITLEMENT

It is widely understood that the courts have the ultimate authority to decide who has the right to produce the CBM. Therefore, the Board could either sidestep the issue by finding it had no ability to determine ownership, or alternately, it could find that it had the limited jurisdiction to determine ownership for the purposes of fulfilling its mandate, namely issuing well licenses.

The Board found that it had both the expertise and the duty to determine ownership in line with how a court would determine the issue. The Decision found that the Board *must* take ownership or other proprietary rights into account when deciding whether to issue a well licence.² The Board also found that the standard of proof in determining ownership is the balance of probabilities, the same standard as a civil court.³

DETERMINATION OF ENTITLEMENT

The Board then determined entitlement to the CBM. In doing so, it considered both the scientific and legal principles as presented by the parties and their expert witnesses.

The Board found that CBM is only weakly physically bonded to coal and that CBM is not "an intrinsic component of coal."⁴ Additionally, due to the low temperature at which methane condenses to a liquid, the Board found that CBM could not exist as a liquid at temperatures and pressures encountered *in situ*. Accordingly, the Board concluded that CBM is a form of gas stored in and produced from coal that is gaseous and distinct from the coal at initial *in situ* conditions.⁵

Having made the technical finding that CBM is gaseous in nature, the Board moved to the legal or common law approach to entitlement. The Board applied the common law test for determining ownership of hydrocarbons, originally used by the Privy Council in *Borys v. Canadian Pacific Railway*⁶ in 1953. That test states that the relevant grants and reservations

must be interpreted in the vernacular, not the scientific sense, as used by landowners, businessmen and engineers of the day. The Board carefully examined the applicable legal principles and found that at the time of the transfer or reservation of title to the "coal" in various separate transactions from the turn of the last century to 1982, the vernacular meaning of "coal" remained that of a solid black combustible rock.⁷ Hence, the Board found that the transfer or reservation of "coal" did not include CBM. In the result, title to CBM was found to rest with the holder of the natural gas rights under all of the instances of split title considered at the hearing.

FUTURE PROCEEDINGS

Decision 2007-024 provides industry with a good measure of certainty, sufficient to allow development of CBM on freehold lands. Nevertheless, the Board was very careful to note that Decision 2007-024 does not determine entitlement to produce CBM for all purposes, expressly noting that the courts have the final say on ultimate ownership. Time will tell if the Decision does in fact determine ultimate ownership. One certainty is its influence will be felt in a number of future legal and regulatory proceedings.

The first and most immediate forum where Decision 2007-024 will be challenged is the Alberta Court of Appeal. The coal owners have applied for leave to appeal from the Decision. But a stay of the Decision has not been requested, such that it will remain in force and effect unless and until overturned by the Alberta Court of Appeal. The test for leave to appeal is quite lax, requiring only an "arguable" case. Given the legal nature of the Board's determinations, it is possible that the Court of Appeal will grant leave to appeal in late 2007. The actual appeal would then be heard in 2008 with a decision likely in early 2009. In assessing the likelihood of a reversal, it is noteworthy that the Board's Decision was carefully drafted to be in line with the applicable authorities, and in harmony with the legislative framework. As well, the findings of fact made by the Board on the nature of CBM will be given a high degree of deference by the Court.

Second, the Decision will immediately come into play in CBM well licensing applications. The Board said that while

the Decision provides a sound basis for the Board's consideration of pending and future applications to produce CBM from split title lands, the Board may consider unique facts and circumstances in the future⁸. Therefore, if unique arguments can be advanced in the future in other hearings, for example due to title grants or reservations different than those considered at the hearing, it is possible that the Board would consider these objections.

The third forum in which the Board's Decision may be considered is in the course of a pure judicial action, advanced in the Court of Queen's Bench, seeking a declaration on ownership of CBM. One of the parties to this hearing has already filed such a statement of claim. It will be interesting to see if an Alberta court will reach the same determination as the Board did, namely, the natural gas owner also owns CBM. While not binding on a court, the Board's Decision will likely be quite persuasive to any judicial determination of ownership. Another factor is whether the courts allow CBM development on the strength of the Decision pending any definitive ruling, subject to accounting for royalty adjustments if necessary.

CONCLUSIONS

The Board went to considerable effort to write a comprehensive and well-grounded decision. It would have been easier for the Board to take a narrow approach and defer the matter for the courts to decide—something that could take upwards of a decade to resolve. By carefully considering all of the evidence and reaching a studied decision on ownership, the Decision offers a clear path for development of the CBM resource from split title lands. The Decision stands as one of Mr. McCrank's crowning achievements as Chair of the EUB.

Footnotes

¹ ST98-2006: Alberta's Energy Reserves 2005 and Supply/Demand Outlook 2006-2015.

² Decision 2007-024, page 10.

³ Decision 2007-024, page 21.

⁴ Decision 2007-024, pages 7-8.

⁵ Decision 2007-024, page 8.

⁶ [1953] 2 D.L.R. 65 (Privy Council)

⁷ Decision 2007-024, page 30.

⁸ Decision 2007-024, page 43.



Good Faith Negotiations

Does Such a Duty Exist?

by Jacob Hoepfner, Student-at-Law

INTRODUCTION – THE GENERAL RULE

As the law in Canada currently stands, the general rule is that there is no cause of action, in tort or in contract, against a party that fails to carry out contractual negotiations in good faith. The authority for this general rule has been adopted from the English jurisprudence where the Courts have commented that such a duty is “...inherently repugnant to the adversarial position of the parties involved in negotiations...” and that in order to negotiate effectively, a party must be able to “...threaten to withdraw from further negotiations or to withdraw in fact, in the hope that the opposite party may seek to reopen the negotiations by offering him improved terms.”¹ Upon addressing the same issue, the Supreme Court of Canada set out the following policy reasons against imposing a duty of care in the case of commercial relationships²:

- ▶ Commercial negotiation sometimes involve goals of achieving financial gain at the opposing party’s expense;
- ▶ Disclosure of one’s motives, final position or bottom line would defeat the essence of negotiation and hobble the marketplace;
- ▶ Such a duty would provide less incentive to perform adequate due diligence;
- ▶ Unless one’s conduct amounts to misrepresentation, deceit, fraud, undue influence or economic duress, it is undesirable for the Courts to scrutinize pre-contractual conduct; and
- ▶ Given the number of negotiations that do not ultimately culminate in an agreement, recognizing such a duty would result in a flood of litigation.

IMPLIED AND EXPRESS DUTIES OF GOOD FAITH

On several occasions, where negotiations have broken down and the parties involved have not included a duty to negotiate in good faith as an express term of their agreement, the offended party has attempted to argue that the Court ought to imply a duty to negotiate in good faith. This was the case in a recent British Columbia decision where a lessee of a gas station attempted to argue that the owner of the gas station was subject to an implied duty of good faith when negotiating a head lease that the owner held with Shell Canada Products Ltd. (“Shell”). The head lease required the gas station to sell Shell products on an exclusive basis in exchange for various incentives that would be made available by Shell. The lessee had made its lease dependent upon the continuing relationship with Shell and when the relationship between the lessee and the owner turned sour, the lessee asked the Court to imply a duty of good faith upon the owner in its lease-renewal negotiations with Shell. After reviewing the jurisprudence, the Court refused to imply such a term and noted that “...[w]hile the law in Canada recognizes the concept of good faith in matters of disclosure, it has not yet embraced that concept in terms of negotiations or bargaining.”³

Even where parties have attempted to protect themselves by inserting an express term into their contract mandating good faith negotiations, Courts have still been reluctant to uphold such provisions. This was observed in the case of *P.P. (Portage) Holdings Ltd. v. 346 Portage Avenue Inc.*⁴ where the plaintiff and defendant had entered into an easement agreement pertaining to an enclosed pedestrian corridor, which linked the plaintiff’s and defendant’s buildings. The contract concerning the

easement contained a term that required the parties to “...negotiate in good faith... in order to settle on terms and conditions of a [new] lease...” prior to the expiry of the current lease. The Manitoba Court of Appeal began by highlighting one of the fundamental contract law rules that mere agreements to agree are unenforceable. The Court then decided that an express agreement to negotiate in good faith was not a binding contract but only an agreement to agree and therefore, could not be enforced.

CIRCUMSTANCES WHERE DUTY OF GOOD FAITH RECOGNIZED

While the general rule of there being no cause of action for failure to negotiate in good faith appears to have been applied by the Courts in most cases, it has been observed in a few narrowly defined circumstances that a Court may recognize a duty to negotiate in good faith. One example arises in cases involving a power imbalance between the contracting parties. For example, the Court in the case of *Wallace v. United Grain Growers Ltd (c.o.b. Public Press)*⁵ indicated that employment contracts are different from ordinary commercial contracts and require a duty of good faith based upon the following factors:

- formation of the contract does not result from two parties with equal bargaining power;
- employees on the whole lack the information necessary to achieve more favourable contract provisions than those offered by the employer; and
- the power imbalance continues to affect other facets of the relationship after the contract has been entered into.

These factors were later applied by the Ontario Court of Appeal in the context of a franchising contract where the Court held that the same factors exist in a franchisor-franchisee relationship.⁶ Therefore, assuming a party could convince a Court that these three factors are applicable to its circumstances; a good-faith negotiation argument may be plausible.

Another circumstance where a Court may be willing to impose a duty to negotiate in good faith is where one of the contracting parties is unilaterally tasked with a discretionary power. For example, in the case of *Greenberg v. Meffert et al.*⁷, where a defendant real estate company was to provide a sales commission to a sales agent at its discretion, the Court held “[a]part altogether from the question of reasonableness, a discretion must be exercised honestly and in good faith.” The Court stated that such discretion could not simply be unbridled, but rather was to be construed as being controlled by objective standards.

One final circumstance worth noting, where the Courts have imposed a duty of good faith, is in circumstances where the parties have agreed, within the context of an otherwise complete and binding contract, to negotiate a specified term outside of the contract. In *Empress Towers Ltd. v. Bank of Nova Scotia*⁸, (“*Empress*”) the Court upheld an obligation

to negotiate in good faith a new rental rate upon renewal of the parties’ lease. The Court held this was not simply an agreement to agree, nor was the clause about the rent uncertain as it required the rent to be the “prevailing market rate”. The certainty of the remaining term was crucial to the finding of the good faith obligation. The same exception was commented upon in *Mannpar Enterprises v. Canada*⁹ (“*Mannpar*”) where a different conclusion was reached. In *Mannpar*, there existed a contract between Mannpar and the Crown for the extraction of sand with a right to renew subject to renegotiating the royalty rate and an annual surface rental. The Crown was not prepared to renegotiate. Mannpar sued on the basis that the Crown repudiated its obligation to renew the lease and had a duty to exercise good faith by negotiating to see if an agreement could be reached. In this case, the Court held that there was no such duty as there was no language to provide an objective benchmark to measure, such as “fair value” or “market value”. These cases suggest that once a Court is satisfied that the contracting parties have surpassed the realms of a mere agreement to agree and have a binding contract, leaving only a term to negotiate that is capable of being measured objectively, a duty to negotiate in good faith may be recognized.

...once a Court is satisfied that the contracting parties have surpassed the realms of a mere agreement to agree and have a binding contract, leaving only a term to negotiate that is capable of being measured objectively, a duty to negotiate in good faith may be recognized.

The difficulty of course is that it is not always as straight forward, as it was in the *Empress and Mannpar* cases, to determine whether or not a contract has in fact been formed. This can be a very grey area as we discussed in our article “*When Negotiations Become a Contract*”, in reference to the recent Alberta case of *Klemke Mining Corporation v. Shell Canada Resources Ltd. et al*¹⁰, in this same issue. In that article we have offered some suggestions for negotiating, which may assist in alleviating some of the uncertainty.

CONCLUSION

For the various policy reasons outlined by Canada’s top Court, a duty to negotiate in good faith is not generally recognized under Canadian contract law. This is usually the case even in circumstances where parties have included an express term to negotiate with each other in good faith. Only in limited circumstances will a Court make an exception to this general rule.

Footnotes

- ¹ *Walford v. Miles*, [1992] A.C. 128 (H.L.)
- ² *Martel Building Ltd. v. Canada*, [2000] 2 S.C.R. 860
- ³ *G.M. Pace Enterprises Inc. v. Tsai*, [2003] B.C.J. No. 2063 (S.C.)
- ⁴ [1999] M.J. No. 354 (Man. C.A.)
- ⁵ [1997] 3 S.C.R. 701
- ⁶ *Shelanu Inc. v. Print Three Franchising Corp.*, [2003] O.J. No. 1919 (C.A.)
- ⁷ (1985), 50 O.R. (2d) 755
- ⁸ [1990] 73 D.L.R. (4th) 400 (BCCA)
- ⁹ [1999] BCJ No. 850 (BCCA)
- ¹⁰ 2007 ABQB 176



Taking Security Interests in IOGC Leases

by Kerry Lynn Okita, Student-at-Law

BACKGROUND

The federal *Indian Oil and Gas Act*, R.S.C. 1985, c. 1-7 and corresponding regulations (Can. Reg. 94-753) provide a distinct regime for granting leases, permits, and licences for the exploitation of oil and gas on First Nations' reserve land. The *Act* and regulations are a relatively recent addition to First Nations property law and were created in response to the growing demand by First Nations for autonomy and control over their resources. The new First Nations Oil and Gas Canada regime, however, leaves a logistical gap with regard to the registration of security interests of rights under the regime.

This article begins by briefly reviewing the First Nations Oil and Gas regime before moving on to describe the situation of security interests and their registration. Following this an alternative will be examined for its potential to fill this particular gap.

WHERE THE ISSUE ARISES

The issue of security interests in reserve land rights arises in several circumstances. First, an oil and gas company holding an oil and gas lease on reserve land may want to include this interest in its borrowing base. Or secondly, an oil and gas company may have partnered with a First Nation or a band-owned company to develop reserve land, and the parties wish to apply for financing as co-borrowers. Since the registry and security of Land Titles does not apply to reserve land, a gap is left by the First Nations Oil and Gas regime in these instances.

THE EXISTING STATE OF AFFAIRS

Indian Oil and Gas Canada ("IOGC") is a special operating agency under the Ministry of Indian and Northern Affairs. The mandate of the IOGC is to administer the oil and gas

resources on reserve land. The Regulations create the position of Executive Director of Indian Oil and Gas, and their office is located on the Tsuu T'ina Reserve in Calgary, Alberta.

The mandate of the IOGC operates within the already existing and extremely unique system of First Nations property rights. Initially, this system was created when the *Indian Act*, R.S.C. 1985, c. 1-5 became legislation in 1876. Due to the complex relationship between the First Nations and the Crown; existing property rights place various restrictions on the use and ownership of reserve land. Notably, First Nation bands cannot exploit their reserve land nor can interests in reserve land be attached by non-First Nations, unless the land is first reverted back to the Crown.

The reversion of reserve land takes place when a First Nation surrenders or designates the land to the to the Crown. The provisions relating to surrender and designation are set out in sections 37 to 41 of the *Indian Act*. The process requires the consent of the Crown as well as the majority of band members. Once the land has been surrendered or designated to the Crown, the land is managed according to sections 53 to 60 of the *Indian Act* and the growing common law interpreting those sections.

The *Indian Act* also creates a Surrendered and Designated Lands Registry, commonly known as the Indian Land Registry, which records the particulars in connection with transactions affecting the land. Leases, permits, and grants are all registered through IOGC, which forwards the documents to Indian and Northern Affairs in Ottawa. Assignments may also be registered and are valid against an unregistered assignment or an assignment subsequently registered.

Unfortunately for creditors, the registry does not operate in the customary manner. While creditors have the opportunity to search and obtain abstracts of title that may reveal

encumbrances, there is no legislative sanction for registration of security interests or their priority. In fact, search results specifically deny liability against the federal Crown for damages arising from errors or omissions. Therefore, registrations are no more than deposits for information. The registry is further limited by the absence of an assurance fund and the absence of provisions to correct errors made by the Registrar. And most importantly, without a proper designation, a lease of reserve land will remain invalid even if the Department for registration accepted it.

While the First Nations Oil and Gas regime has significantly altered the development of oil and gas resources on reserve land, large gaps still remain. The limitations of the registry system have not allowed creditors to take advantage of the full benefits they are accustomed to on non-reserve land. While these gaps are currently being addressed by the federal government and hopefully will be resolved with a more comprehensive system shortly, another alternative may be available in some situations.

AN INTERIM ALTERNATIVE

Section 426 *Bank Act*, R.S.C. 1991, c. 46 security may provide a solution for chartered banks who have security interests on reserve land. This provision allows banks to lend money on security of hydrocarbons or minerals and by taking this security, the bank effectively becomes the legal owner of the property. This also ensures that the bank obtains priority over rights subsequently acquired. While the *Bank Act* does not provide a complete solution to the gap regarding security interests on reserve land interests, the legislated priority offers a significant alternative to chartered banks.

CONCLUSION

The IOGC has created a unique niche within First Nations property law in order to facilitate increased autonomy among First Nations and the more efficient development of oil and gas rights on reserve land. While this regime is a significant step forward in many regards, the logistical gap of security interest registration currently remains problematic for creditors. This current limitation will no doubt be worked out some time in the near future, and in the meantime the *Bank Act* may provide an alternative form of protection.



Energy

BD&P's Energy Team practitioners are recognized and respected leaders in their field, advising on all aspects of domestic and international energy projects and transactions, joint ventures, alliances and mergers and acquisitions.

We represent a diverse range of clients in the petroleum industry including explorers, developers, producers, pipeline and transportation owners and operators, facilities owners and operators, lenders, public and private investors, marketers, aggregators, retailers and traders.

Our Energy Team works closely with other professionals in the firm drawing on the depth of knowledge of lawyers in tax, securities, construction, intellectual property and technology, employment and labour, and oil and natural gas and electricity regulatory law. We are active in a number of professional organizations relevant to the industry including the PJVA, CPLF, SEPAC, CAPL, Natural Resources Subsection of the CBA and the Institute for Energy Law.

The practitioners on BD&P's Energy Team offer strong legal skills, practical and experienced business advice, innovative solutions and timely response to meet the specific needs and objectives of our clients.

SIGNIFICANT AREAS OF SERVICE:

- Development of opportunities in Alberta's oil sands including front-end engineering and design, engineering, procurement, construction management and construction
- Leading edge projects such as coal bed methane projects
- Joint venture, farmout, operating, royalty, participation and transportation agreements
- Acquisitions and dispositions of oil and natural gas properties and facilities
- Share transactions involving both private and public companies
- Natural gas marketing issues and sales agreements
- Construction, financing and operating of petrochemical plants and pipelines
- Corporate reorganizations
- Environmental issues
- Oil and natural gas taxation issues including cross-border transactions
- Oil and natural gas financings
- Co-generation projects
- Onshore and offshore drilling contracts
- International transactions
- Due diligence reviews, including title reviews and opinions
- Surface rights work
- First Nations consultation advice

Energy Litigation

BD&P's Energy Litigation Team has extensive experience in all oil and gas related issues giving rise to litigation. The team compliments and is complimented by the strength of the firm's energy law practice, enabling the litigators to work closely with colleagues in order to provide all the resources key to resolving the client's oil and gas issues.

This Team regularly appears before all level of Alberta's Courts, in courts of other provincial jurisdictions, and before regulatory and administrative tribunals. In addition, the Energy Litigation Team has significant experience in the alternative dispute resolution forums of mediation and arbitration. In order to accomplish our clients' objectives, the BD&P energy litigators are committed to finding practical, efficient and cost-effective solutions for our clients in all contentious oil and gas related matters.

SIGNIFICANT AREAS OF SERVICE:

- Joint Ventures
- Farmout Agreements
- AMIs
- Royalty disputes
- Royalty or title claims by First Nations or by the Federal Crown as their trustee
- Accounting disputes
- Operating disputes
- Fiduciary duties
- Lease interpretations including rights of first refusal and other title questions
- Environmental liabilities
- Oil and gas evaluation disputes

Energy Regulatory

BD&P's Regulatory Team has a wealth of experience involving all aspects of oil & gas and electricity regulatory proceedings, including projects subject to federal and/or provincial environmental assessment legislation. Our lawyers appear regularly before the National Energy Board, the Alberta Energy and Utilities Board, the Alberta Environmental Appeal Board, Environment Canada, the Alberta Surface Rights Board, the Northwest Territories Public Utilities Board, the British Columbia Utilities Commission and other regulatory authorities in other provinces and territories. In addition, BD&P has acted as counsel in regulatory appeals and judicial review applications in the Alberta Court of Queen's Bench, the Alberta Court of Appeal, the Federal Court and the Supreme Court of Canada.

The BD&P Regulatory Team represents oil & gas producers, oil sands producers, owners of intra-provincial, inter-provincial and international transporters of natural gas and crude oil pipelines, owners of NGL extraction plants, petrochemical facilities and refineries, proponents of LNG projects, owners and proponents of generating plants, owners of regulated electricity transmission and distribution facilities, regulated and unregulated retailers of electricity and gas services, buyers and owners under Power Purchase Arrangements, and energy marketers and importers/exporters.

In recent years, BD&P has been on the leading edge of restructuring in Alberta's electricity and natural gas marketplaces.

SIGNIFICANT AREAS OF SERVICE:

Oil & Gas:

- securing facility, environmental and land use planning approvals for oil and gas projects of all scale and scope – oil and gas wells, gas processing facilities, pipelines, oil sands projects, NGL extraction plants, petrochemical plants, refineries and LNG terminal facilities
- representing clients in tolls, tariff and access proceedings for natural gas and crude oil pipelines
- acting for clients in rateable take disputes, common carrier and common processor applications and resource conservation and enhanced recovery schemes
- representing project proponents in land acquisition and compensation proceedings
- providing counsel on regulatory matters involving consultations and disputes with local land owners and non-governmental organizations
- providing counsel on First Nation matters related to oil and projects, including consultation obligations and treaty and traditional land access
- advising market participants on issues arising under affiliate codes of conduct.

Electricity:

- representing clients in rates and tariff proceedings involving electric utilities and the Alberta Electric System Operator
- securing facility, environmental and land use planning approvals for electric transmission lines and co-generation, simple/combined cycle and hydro generating facilities
- advising market participants on issues arising under affiliate codes of conduct, market participation rules and the financial settlement rules of the Alberta Independent System Operator
- representing project proponents in land acquisition and compensation proceedings
- providing counsel on regulatory matters involving consultations and disputes with local land owners and non-governmental organizations
- providing counsel on First Nation matters related to electric facilities, including consultation obligations and treaty and traditional land access

Energy Lawyers

ENERGY

Allford, R. Bruce	rba@bdplaw.com	..... 260-0247
Campbell, Q.C., Harry S.	hsc@bdplaw.com	..... 260-0281
Cuthbertson, John H.	jhc@bdplaw.com	..... 260-0305
Goetz, John C.	jc@bdplaw.com	..... 260-0110
Houston, Mark T.	mt@bdplaw.com	..... 260-0375
Johnson, Q.C., Cal D.	cdj@bdplaw.com	..... 260-0203
Jones, Candice J.	cjj@bdplaw.com	..... 260-0109
Money, J. Stuart	jsm@bdplaw.com	..... 260-0312
Olyan, Arnold H.,(Arnie)	aho@bdplaw.com	..... 260-0249
Pettie, Alan T.	atp@bdplaw.com	..... 260-0127
Polson, Rory G.	rgp@bdplaw.com	..... 260-0223
Pybus, Kathy L.	klp@bdplaw.com	..... 260-0196
Quesnel, Alicia K.	akq@bdplaw.com	..... 260-0233
Taylor, John K.	jkt@bdplaw.com	..... 260-0386
Twa, Q.C., Allan R.	art@bdplaw.com	..... 260-0221
Wivcharuk, Jody L.	jlw@bdplaw.com	..... 260-0129
Wright, Carolyn A.	caw@bdplaw.com	..... 260-5721

ENERGY – REGULATORY

Brander, R. Bruce	rbb@bdplaw.com	..... 260-0165
Liteplo, Jonathan M.	jml@bdplaw.com	..... 260-0310
Lowe, John E.	jel@bdplaw.com	..... 260-0257
Miller, Keith F.	kfm@bdplaw.com	..... 260-0153
Quinton-Campbell, Patricia	pqc@bdplaw.com	..... 260-0308

ENERGY- LITIGATION

Beke, Paul A.	pag@bdplaw.com	..... 260-0216
Crump, Barry R.	brc@bdplaw.com	..... 260-0352
Donaldson, Michael J.	mjd@bdplaw.com	..... 260-0228
Haigh, Q.C., David H.	drh@bdplaw.com	..... 260-0135
McDonald, Q.C., Daniel J.	djm@bdplaw.com	..... 260-5724
McDonald, Trevor R.	tmcDonald@bdplaw.com	..... 260-0378
McGillivray, Q.C., Douglas A.	dam@bdplaw.com	..... 260-0349
Millard, Robert O.	rom@bdplaw.com	..... 260-5719
Mills, Douglas G.	dgm@bdplaw.com	..... 260-0226
Murphy, James D.	jdm@bdplaw.com	..... 260-0152
Nishimura, Doug S.	dsn@bdplaw.com	..... 260-0269
Novinger Grant, Louise	lng@bdplaw.com	..... 260-0163
Sharpe, Jeff E.	jes@bdplaw.com	..... 260-0176
Steele, Richard F.	rfs@bdplaw.com	..... 260-0051
Strand, David H.	dhs@bdplaw.com	..... 260-0259
Tuohy, Kevin J.	kjt@bdplaw.com	..... 260-0299
Vogeli, L. Grant	lgv@bdplaw.com	..... 260-0171
Wood, Robert D.	rdw@bdplaw.com	..... 260-0125
Wray, Shannon L.	slw@bdplaw.com	..... 260-0245

If you would like any further information on any members of our team, such as a more detailed resume, please feel free to contact the team member or the writer directly. You may also refer to our website at www.bdplaw.com.

o n r e c o r d

ENERGY MATTERS AND OTHER ISSUES OF **ON RECORD** ARE AVAILABLE ON OUR WEB SITE WWW.BDPLAW.COM
 For a complete list of authorities used in drafting these articles please contact the Managing Editor.

Energy Matters, Editors-in-Chief

John H. Cuthbertson, jhc@bdplaw.com..... (403)260-0305
 Alicia K. Quesnel, akq@bdplaw.com (403)260-0233

Energy Matters, Managing Editor

Rhonda G. Wishart, rwishart@bdplaw.com..... (403)260-0268

Contributing Writers and Researchers:

John E. Lowe, Jacob R. Hoepfner, Simon J. Lee,
 Kerry Lynn Okita and Catherine B. Reyes.

Contact

For additional copies, address changes, or to suggest articles for future consideration, please contact our Catherine Leitch in our Marketing Department at (403) 260-0345 or at cat@bdplaw.com.

General Notice

On Record is published by BD&P to provide our clients with timely information as a value-added service. The articles contained here should not be considered as legal advice due to their general nature. Please contact the authors, or other members of our energy team directly for more detailed information or specific professional advice.