



Burnet,
Duckworth
& Palmer LLP
Law Firm

ENERGY

M A T T E R S

JANUARY 2006

Court of Appeal Imposes Obligations on Shallow Rights Holders

by John Wilson,
Student-at-Law

INTRODUCTION

In the recent case of *Xerex Exploration Ltd. v. Petro-Canada*, 2005 ABCA 224, the Alberta Court of Appeal determined that a shallow rights holder negotiating with the holder of deeper zone rights must disclose the information about deeper zones that is obtained while drilling an over-hole allowance. In fact, the shallow rights holder was held to have a fiduciary duty to the deeper rights holder to provide such disclosure.

FACTS

The case involved a dispute relating to a well drilled in the Two Creek Area west of Swan Hills, Alberta (“the Well”). Petro-Canada had a lease giving it the exclusive right to explore to the base of the Bluesky-Bullhead group of formations (the “Shallow Rights”). Xerex Exploration Ltd. (“Xerex”) had a licence to explore the region below (the “Deep Rights”).

On November 13, 1996, the Alberta Energy and Utilities Board issued a licence to Petro-Canada to drill the Well into the Shallow Rights. The terms of the licence included the right to drill 15 metres past the zone boundary, into the Deep Rights. The purpose behind this over-hole allowance was to accommodate logging tools and casing that would allow Petro-Canada to explore fully the Shallow Rights. The licence also provided that drill cutting samples were to be taken at five-metre intervals from 30 metres above the zone boundary to total depth.

– continued on page 2

in this issue:

The Supreme Court of Canada Rules on GAAR	2
Structuring your Business for International Competitiveness.....	4
Rights and Remedies of Operators and Working Interest Owners.....	5
Initial Adjustment Statements and Closing Certificates	7
Curing the Unintended Tax.....	8
Energy, Energy Litigation, Regulatory – Energy	9
Energy Lawyers Contact Information	Back Cover

– continued from cover

Petro-Canada drilled 15 metres into the Deep Rights as provided for by the licence. However, instead of collecting samples in five-metre intervals, Petro-Canada collected samples in one-metre intervals. The samples taken from the Deep Rights contained oil stains or “shows”, which indicated a potentially productive zone.

Later that day, the assigned Petro-Canada landman contacted Xerex and offered to purchase the Deep Rights from Xerex. Xerex asked, “Have you drilled into this?” to which the landman responded “No.” The Petro-Canada landman also reminded Xerex that its licence was going to expire in approximately three weeks if a well was not drilled and indicated that Petro-Canada had a rig onsite that was capable of drilling a well that could convert the licence into a lease.

Following the conversation with Xerex, the Petro-Canada landman reported to his principals that the Deep Rights had been successfully acquired. Drilling was resumed that evening and the Deep Rights were penetrated a further seven metres. In fact, an agreement was not reached until two days later, when Xerex agreed to sell the Deep Rights for a three percent gross overriding royalty (the “GORR”). On November 27, 1996, Petro-Canada applied successfully to have its newly acquired Deep Rights licence converted to a lease. Limited production occurred over the following year and no royalties were paid to Xerex.

On July 23, 1998, Petro-Canada sold the Well and other lands to Progress Energy Ltd. (“Progress”). Prior to the acquisition, Progress enquired about the GORR, as it appeared to be payable in favour of Xerex, but was given a Petro-Canada solicitor’s opinion that it was not applicable as a result of a changed zone boundary. However, neither Progress nor the Petro-Canada solicitor who gave the opinion were aware that Petro-Canada (without notice to Xerex) had a purported misdescription of the zone boundary corrected after the GORR was given to Xerex.

Progress successfully developed the Well and other acquired lands, but relying on the solicitor’s opinion, did not pay any royalties to Xerex under the GORR. In the spring of 1999, Xerex learned of the

production from the Well and also learned that Petro-Canada had drilled the Well prior to acquiring the Deep Rights licence from Xerex. Xerex promptly filed suit against Petro-Canada and Progress.

TRIAL DECISION

At trial it was held that once the Petro-Canada landman raised the issue of Petro-Canada’s drilling activities in his conversation with Xerex, the landman was obliged to tell the whole story. Not disclosing the full extent of Petro-Canada’s drilling activities once the subject was raised in that discussion amounted to an actionable misrepresentation. The trial judge held that if it were not for this misrepresentation Xerex would have likely negotiated a 50/50 farmout arrangement with Petro-Canada. Petro-Canada was therefore ordered to pay \$8M in damages to Xerex. The claim against Progress was dismissed and, since the damage award properly compensated Xerex, the GORR was terminated.

COURT OF APPEAL DECISION


On appeal, the Court upheld the trial judge’s finding of liability based on misrepresentation by incomplete disclosure and the assessment of damages. However, the Court of Appeal went further. First, it was held that the Petro-Canada landman’s comments to Xerex amounted to misrepresentation by false statement. Second, it was held that in the circumstances of this case, Petro-Canada was in the position of a fiduciary to Xerex when negotiating its purchase of the Deep Rights.

The Court of Appeal emphasized that the purpose of an over-hole allowance is to allow the shallow rights owner to explore fully their rights, not to acquire information relevant to the exploration and possible development of the deeper zone. However, since the opportunity to become privy to such information will always exist in such situations, the Court held that legal restrictions must be imposed on the use of that information to protect the owners of deep rights.

In the present case, Xerex was placed in an extremely vulnerable position since Petro-Canada had information about the possible presence of hydrocarbons in the deeper zone. This vulnerability was exacerbated when Petro-Canada approached Xerex to negotiate the sale of the Deep Rights. As such, it was held that in conducting that negotiation, Petro-Canada owed Xerex a fiduciary duty. With respect to the scope of the fiduciary duty, the Court held that Petro-Canada had a duty to disclose that it had drilled into the Deep Rights and to answer any questions Xerex might have had about what might have been observed or discovered.

QUESTIONS RAISED

The Court of Appeal points out that imposing such an obligation on the shallow-rights holder raises a number of other questions that remain unanswered. For example, is there a general duty on the shallow-rights holder to disclose information when nothing particularly useful is observed or if the shallow rights holder does not intend to make use of the information obtained? Could a party in Petro-Canada’s position simply wait until the deep-rights licence expired and then acquire the licence for itself, without making disclosure? Answers to these and other similar questions will largely depend on how the present case is interpreted and applied by courts in the future, but the caution is clear.



...the Court held that Petro-Canada had a duty to disclose that it had drilled into the Deep Rights and to answer any questions Xerex might have had about what might have been observed or discovered.



The Supreme Court of Canada Rules on GAAR

by Heather R. DiGregorio

INTRODUCTION

The Supreme Court of Canada recently released its first two decisions on the infamous general anti-avoidance rule (“GAAR”), *Canada Trustco Mortgage Co. v. Canada*, 2005 S.C.C. 54 (“Canada Trustco”) and *Mathew v. Canada*, 2005 S.C.C. 55 (“Mathew/Kaulius”). The principles for interpreting GAAR which are laid out in these decisions provide important guidance for planning transactions by helping to clarify when tax avoidance may be considered abusive and thus subject to GAAR.

BACKGROUND

GAAR was enacted in 1988 and was intended to act as a type of catchall to close loopholes in the *Income Tax Act*, denying benefits to taxpayers even in cases where there was no specific provision of the *Income Tax Act* that would do so. Until the release of the *Canada Trustco* and the *Mathew/Kaulius* decisions, there was some uncertainty for taxpayers and tax planners with respect to when the Canada Revenue Agency (the “CRA”) would challenge a tax plan, asserting GAAR.

GAAR was enacted in 1988 and was intended to act as a type of catchall to close loopholes in the Income Tax Act...

CLARIFICATION OF GAAR’S APPLICATION

The Supreme Court of Canada has now made it clear that tax avoidance is allowed, so long as it does not cross the line where it becomes “abusive” tax avoidance. Moreover, it has placed the onus on the CRA to prove that a tax plan is abusive and not just clever.

The Supreme Court confirmed that a taxpayer is entitled to structure its affairs to minimize tax, so long as the tax minimization is “legitimate”. Therefore, GAAR will apply only when the following three requirements are met:

- ▶ there must be a tax benefit that arose as a result of a transaction or a series of transactions;

- ▶ the transaction was an avoidance transaction, in the sense that it cannot be said to have been reasonably undertaken primarily for a *bona fide* purpose other than to obtain a tax benefit; and
- ▶ the avoidance transaction must be abusive.

The onus to disprove the first two criteria lies on the taxpayer. The Supreme Court of Canada has set the threshold very low for these criteria, and often if the CRA is challenging a taxpayer’s transaction, then these criteria are likely to have been met.

In the majority of cases, therefore, the dispute between a taxpayer and the CRA will be over the third criterion, i.e., whether a particular tax plan constitutes an “abusive” avoidance transaction. As mentioned above, the onus lies on the Minister to prove that there was abuse. Abusive avoidance transactions occur when a taxpayer relies on specific provisions of the *Income Tax Act* to achieve an outcome that those provisions seek to prevent. In other words, abuse occurs when a transaction defeats the underlying purpose of the provisions relied upon.

– continued on page 3

– continued from page 2

The abuse analysis is based primarily on a textual, contextual and purposive interpretation of the provisions in question. It requires a court to look beyond the mere text of the *Income Tax Act* to the object, spirit and purpose of the provisions that were relied on by the taxpayer. Once the object, spirit and purpose of the provisions are identified, a court is to decide whether the tax plan, and its resulting transactions, either fall within the purpose of the provisions or frustrate that purpose. If the object, spirit and purpose of the provisions have been frustrated, then abusive tax avoidance has occurred.

THE SUPREME COURT OF CANADA DECISIONS

The *Canada Trustco* and *Mathew/Kaulius* cases provide examples of each end of the spectrum (i.e., when tax avoidance is legitimate and when it is not). In *Canada Trustco*, the Supreme Court of Canada approved the benefit achieved by a tax plan because it was not abusive. However, in *Mathew/Kaulius*, the tax plan was found to be abusive, and the benefits that it had produced were denied to the taxpayers.


Canada Trustco involved a complicated sale and leaseback transaction. The overall result was that a corporation purchased assets and

was able to claim a significant amount of capital cost allowance (“CCA”) (commonly known as depreciation expense) for those assets, against its income in a year. This significantly lowered its taxable income. The leaseback, however, had been prepaid in full, thus eliminating most of the risk in the transaction for the purchaser. The CRA argued that GAAR should overrule the CCA provisions of the *Income Tax Act* when the purchaser of the assets undertakes little or no economic risk. The Supreme Court of Canada disagreed. In applying the principles discussed above, the Supreme Court held that there was no underlying policy to the CCA provisions that required a purchaser to undertake economic risk prior to deducting CCA from its income. Thus, the transaction did not frustrate the object, spirit and purpose of the provisions relied upon.

Mathew/Kaulius involved the shifting of losses, which had been incurred by one taxpayer, to other arm’s-length taxpayers. The shifting of losses was accomplished using a combination of the loss-preservation and partnership provisions of the *Income Tax Act*. The overall result was that several arm’s-length taxpayers claimed losses against their income which they had not incurred themselves, thereby lowering their overall taxable income. The Supreme Court held that the purpose behind the loss-preservation and partnership provisions was to prevent the sale of losses between arm’s-length parties. Thus, the purpose behind the provisions was frustrated by the taxpayers’ transactions, and therefore the tax benefit was disallowed.

CONCLUSION

The *Canada Trustco* and *Mathew/Kaulius* decisions appear to give taxpayers and their advisors comfort that commercially motivated tax advantaged transactions will not ordinarily be subject to GAAR challenges unless they seek to apply or rely on one or more provisions of the *Act* outside of their original context (i.e., unless they take advantage of loopholes). The decisions also confirm that the GAAR can be applied to strike down tax shelter investments that are not sanctioned by the *Act* and instead seek to legitimize themselves by relying on the application of one or more of its provisions out of its intended context.



The *Canada Trustco* and *Mathew/Kaulius* cases provide examples of each end of the spectrum (i.e., when tax avoidance is legitimate and when it is not).

Structuring your Business for International Competitiveness

by Michel H. Bourque

The recent decision of the Tax Court of Canada in *Dunbar v. The Queen*, 2005 TCC 769, provides a good reminder of the benefits of the Overseas Employment Tax Credit (“OETC”) for Canadian residents working outside Canada, particularly in the exploration for or exploitation of petroleum, natural gas, minerals or similar resources or in any construction, installation, agricultural or engineering activity. Under the *Income Tax Act*, those employees who qualify for the OETC are entitled to exclude from their income up to 80% of the first \$100,000 of income earned outside Canada. The OETC was enacted to enhance Canadian businesses’ competitiveness in foreign markets.

In *Dunbar*, the taxpayer was the captain of a super-tanker (the “VLCC”—very large crude carrier) which transported crude oil from the Arabian Gulf to Saint John, New Brunswick for refining at Irving Oil’s refinery. An English company, Norbulk Shipping, contracted with Dunbar’s employer, Ocean Services Limited, to provide officers to operate the VLCCs in connection with the transportation of the two million plus barrels of crude oil.

The issue before the Court was whether the business of Ocean Services was in respect to the exploitation of petroleum. Justice Miller held that “exploitation means more than simply extracting and selling” and that “shipping crude oil where it can be refined is part of that overall exploitation, especially so where measures have to be taken to ensure the crude arrives safely”. He also agreed with the taxpayer that it was only when the value of the crude oil had been optimized that it had been turned to account—meaning the exploitation process. Justice Miller also drew an important distinction between employees of placement agencies (who do not qualify for the OETC) and subcontractors (who may qualify for the OETC).

Proper structuring and careful planning may enable Canadian employees to qualify their employees for the OETC. As a trade-off, Canadian employees will generally agree to lower wages in consideration for the fact that they qualify for the OETC. As a result, Canadian employers can structure their bids on international work proposals at a lower cost, thus increasing their competitiveness outside Canada.

The issue before the Court was whether the business of Ocean Services was in respect to the exploitation of petroleum.



INTRODUCTION

Operators of oil and gas properties in Alberta occupy a prominent position in the industry. Proper exploitation and development of petroleum and natural gas resources including the provision of income from these properties is dependent on operators' efforts.

At the same time, operators are dependent on working interest owners for capital in order to produce revenues from petroleum and natural gas properties. Operators are typically required to be the initial source of funds for the development and tie-in of such properties. Operators must recoup their expenses from working interest owners and, upon default of such payment by working interest owners, operators are left "holding the bag".

Some recent issues have arisen regarding the ability of operators to recover from defaulting working interest owners as well as the ability of working interest owners to remove an operator from its position and replace it with a new operator. This article is intended to be a brief primer on the remedies available to operators with respect to defaulting parties and, correspondingly, the remedies available to working interest owners to address concerns regarding operators.

THE OPERATOR

The relationship between operators and working interest owners is generally governed by the Canadian Association of Petroleum Landmen ("CAPL") Agreement. The CAPL Agreement is a standard industry contract, which has been modified from time to time. In general, the CAPL Agreement provides for the appointment of an operator who has direct control of developing and operating oil and gas properties for working interest owners. The CAPL Agreement provides generally for the method by which operators will fund operations and recoup expenses from working interest owners, distribute revenues to working interest owners and deal with disputes.

In the ordinary course, operators obtain approval for expenditures by the issuance of Authorities For Expenditure or "AFE" which are signed by working interest owners. The signature of a working interest owner on an AFE signifies the approval by the working

Rights and Remedies of Operators and Working Interest Owners

By Doug S. Nishimura



interest owner of all expenditures related to the particular project, including reasonable expenditures over and above the estimate on the AFE. The operator proceeds to engage contractors for the project. The operator, and not working interest owners, becomes liable to contractors for payment. The operator then recovers the costs from working interest owners by issuing invoices.

Because of the foregoing chain of events, operators are the initial funders of the capital projects in a petroleum and natural gas operation. For some time, they are therefore exposed for the cost of the project, which is to be recouped from other working interest owners. Without more, operators would

be left to undertake lengthy and expensive litigation to recover expenses from defaulting working interest owners.

Because of this risk to the operators they are granted enhanced remedies under the various CAPL Agreements. Chief among the remedies available to operators is the agreement by the parties in the CAPL to an "operator's lien". Under section 505(a) of the CAPL Agreement, operators are given a lien over all of a defaulting working interest owner's interest in the subject property. Upon enforcing the lien, operators can direct the defaulting working interest owner's revenues to payment of the outstanding obligation to the operator.

In order to enforce an operator's lien, some technical requirements must be followed. For example, the 1990 CAPL Agreement requires that an operator must, prior to enforcing a lien, issue a notice of default to the working interest owners, specifying the precise default and providing 30 days to remedy the default.

The steps under the other versions of the CAPL Agreement are similar.

In the recent decision of *Direct Energy Marketing Ltd. v. Kalta Energy Corp.*, [2002] A.J. No. 463 (Q.B.), the Court of Queen's Bench of Alberta held that in order to maintain priority of a contractual lien, operators or processors had to register a security interest at the Personal Property Registry of Alberta. Upon doing so, the operator's lien would enjoy the priority set out in the *Personal Property Security Act*, which would generally mean that the lien would enjoy priority over any subsequent security interests and also against unsecured creditors. Absent registration, the operator would risk losing any priority with respect to its claim, especially against a Trustee in bankruptcy or prior registered secured creditors.

The registration requirement poses a dilemma for operators who ordinarily would not wish to incur the expense of registration, which could also create defaults for working interest owners in their on-going banking relationships. It is perhaps prudent for operators that they register an operator's lien upon default by the working interest owner, but not before.

Operators can also exercise a contractual right of set-off under the CAPL Agreement. In addition, operators are also entitled to collect the debt owed by the defaulting working interest owner from the other working interest owners on a pro rata basis. The other working interest owners must then look to the original defaulting party to recover the additional expense.

Operators may also withhold "information and privileges" of a defaulting party under the 1990 CAPL Agreement. Just what constitutes "information and privileges" has not yet been judicially determined. In a very recent and yet to be decided case, a dispute had arisen as to whether the right of a working

interest owner to vote at a meeting of working interest owners was a privilege affected by the provision. Notably, the draft 2006 CAPL Agreement refers to "information and rights" of working interest owners. Arguably, this clarifies that all incidents of working interest ownership are compromised when the working interest owner has defaulted in payment.

The final "usual" remedy for operators is simply to sue defaulting parties for the outstanding debt. Obviously, litigation is time consuming and potentially expensive. Accordingly, it is the least desirable legal step for operators to enforce debts from working interest owners.

Because working interest owners are not in the same position as operators in that they do not typically advance funds for operations and are not liable to contractors for bills...

THE WORKING INTEREST OWNERS

Because working interest owners are not in the same position as operators in that they do not typically advance funds for operations and are not liable to contractors for bills, but rather simply respond to invoices, working interest owners do not enjoy enhanced remedies to collect debts from operators. In general, operators will not incur indebtedness to working interest owners. The remedies for working interest owners mainly revolve around the ability of working interest owners to obtain information and accounting from operators with respect to ongoing expenses and the ability of working interest owners to remove an operator with whom they are dissatisfied.

With respect to information and accounting, the CAPL Agreement requires operators to provide information to working interest owners upon request. Further, working interest owners have the ability to demand an audit of the operator's accounting with respect to the operation.

If working interest owners believe that operators have overcharged or, through negligence, have caused damages to working

interest owners, the working interest owners may attempt to address the situation by suing the operator for damages.

Sections 202 - 203 of the CAPL Agreement provide for the removal of an operator by working interest owners. There are several ways in which this can occur.

First, if two or more working interest owners, holding over 50% of the working interest, vote to remove an operator and replace the operator with an alternative, the operator must step aside. As mentioned above, if one of the voting working interest owners has defaulted in its payment to the operator, it is arguable that they are not entitled to vote.

Second, if a single working interest owner holding more than 66% working interest in the property gives notice to the other parties, it can replace an operator and become the operator itself.

Third, an operator can be removed if it defaults in its obligations. This can only occur if it receives 30 days notice from a majority of the working interest owners. The notice must specify the default and require the operator to remedy the default. The operator can avoid removal if it commences diligent steps to rectify the default.

Fourth, after 2 years, a working interest owner other than the operator can issue a "challenge notice" to the other working interest owners. This challenge notice will state that the working interest owner is "ready, willing and able" to conduct operations on more favourable terms and conditions than the present operator. The present operator has 60 days to advise the working interest owners either that it is prepared to operate on the terms and conditions set out in the challenge notice or that it is not prepared to do so and that it will resign as operator. If the operator fails to respond, it is deemed to have elected to resign.

Finally, an operator can be removed if it is bankrupt or insolvent. However, if an operator enters into proceedings under the *Companies Creditors Arrangement Act* ("CCAA") it cannot be removed. This is because the stay of proceedings under the CCAA operates to prevent a working interest owner from forcing the removal of the operator from its position.

Initial Adjustment Statements and Closing Certificates

by Danielle M. Parrotta



INTRODUCTION

Re *Gauntlet Energy Corp.*, [2005] A.J. No. 1108 (Q.B.) is a recent Alberta case involving a dispute between the parties to an acquisition regarding the entitlement to the benefit from the Gas Cost Allowance. The decision of the Court emphasizes, among other things, the requirement of giving careful consideration to the initial adjustment statements and closing certificates in a transaction.

FACTS

Gauntlet Energy Corp. (“Gauntlet”), like other oil and gas producers, was obliged to pay provincial Crown royalties on all of the hydrocarbons it produced in Alberta. Gauntlet was entitled to claim various types of credits against those royalties - one being the Gas Cost Allowance credit (the “Credit”). The Credit is calculated based upon the useful life of the reserves to be produced through the processing facility for which the claim for the Credit is made. The Credit may be changed by filing a variation notice (“Variation Notice”) if a change is made to the predicted useful life of the reserves.

On June 17, 2003 Gauntlet obtained protection from its creditors while it tried to reorganize its affairs. The reorganization involved the acquisition by Ketch Resources Trust (“Ketch”) of all of the issued and outstanding shares of Gauntlet under a court-approved plan of arrangement. The acquisition closed on December 8, 2003 subject to a number of post-closing adjustments to be made between Gauntlet and Ketch. The same day as closing, Gauntlet filed the Variation Notice to claim the accelerated Credits.

ISSUE

The issue in the application before the Court was entitlement to the benefit of the accelerated Credits generated by Gauntlet filing the Variation Notice and how such Credits should be accounted for as between Gauntlet and Ketch in the final statement of adjustments.

DECISION

Ketch’s position was that the filing of the Variation Notice was a breach of a representation and warranty and covenant in the Subscription Agreement and that the structure of the transaction created a fiduciary duty on Gauntlet to manage the assets for the benefit of Ketch. Ketch also argued that the Credits should not be included in the final statement of adjustments because Ketch felt the Credits were not a “current asset”. Gauntlet took the opposite position on all points. In the final decision, Ketch was unsuccessful in establishing Gauntlet’s fiduciary duty or a breach by Gauntlet of acting in the ordinary course of business. However, the Court held that Gauntlet breached a representation and warranty and a covenant by not disclosing to Ketch its change in accounting practice (by accelerating the Credits) and not providing Ketch with a copy of the Variation Notice. Under the Subscription Agreement, Gauntlet was required to provide, at closing, a certificate indicating that the representations, warranties and covenants made in the Subscription Agreement were true as at closing. In response to this requirement, Gauntlet provided a clean certificate at closing whereas Gauntlet should have provided a certificate indicating the breach of the filing covenant and the fact that a representation and warranty was no longer true. Thus, the Court was left with the valuation of Ketch’s loss of a right to negotiate what would most likely have been a reduction in the purchase price due to Gauntlet’s breach.

As part of the final decision, the Court also had to determine whether the Credits could be properly categorized as a “current asset”. The Court determined the Credit was indeed a “current asset” because the initial adjustment statement tabled at closing had a line item on it for the Credit. The Court held that even though the estimate at the time of closing for the Credit was zero, the Subscription Agreement contemplated that “...zero dollar amounts [were] to be determined with the benefit of hindsight prior to final adjustment” and actual working capital may include an estimate of some charges which have not yet become actuals.

POINTS WORTH NOTING

Certain practice points that are reinforced in this case include:

1. Accuracy of and proper disclosure within closing certificates. This item is important as most parties would prefer to negotiate a change in purchase price, if deemed necessary, rather than have the inaccuracies resolved by the Court.
2. Tabling substantially complete initial adjustment statements. Such statements, tabled at or prior to closing, should include all potential line items. This level of detail will assist parties to a transaction in addressing their minds to and determining post-closing actuals in addition to items that will require determination at the final adjustment stage.

Curing the Unintended Tax

by Michel H. Bourque

UNINTENDED TAX CONSEQUENCES OF A TRANSACTION

From time to time, parties to a commercial transaction enter into written agreements that do not reflect the parties' true intention. These circumstances usually come to light when unintended tax consequences associated with the unintended commercial arrangements arise. While there may be an inclination to address the problem by merely amending agreements or substituting pages in the agreements, there is a significant risk that the Canada Revenue Agency ("CRA") will not assess those amended transactions on a retroactive basis. A possible solution may be to apply to the superior court of the province for an order seeking rectification of the transactions.

DOCTRINE OF RECTIFICATION

Rectification is an equitable remedy that is used to rectify documents that do not reflect the true agreement of the parties to a transaction. This remedy can be obtained where the written agreement does not reflect the bargain between the parties and where the parties share a common continuing intention up to the time of signature that the impugned clause or provision in the written document stand as agreed rather than as reflected in the agreement. Application for rectification is made to the provincial superior courts rather than the Tax Court.

RECENT CASELAW

Following the recent Ontario Court of Appeal decision in *Juliar v.R.*, [2001] 4 C.T.C. 45 (Ont. C.A.) ("*Juliar*") tax litigation practitioners have found such applications to be a useful tool in order to ensure that the intended tax treatment of the transaction is achieved. There are generally two reasons

why obtaining an order of rectification is important: (1) the Tax Court, not being a court of equity, is limited by its statutory jurisdiction and cannot order or consider applying equitable principles such as rectification in tax appeals, and (2) the Tax Court is bound by orders of rectification obtained from provincial superior courts. In the absence of an order, the Tax Court would be bound to consider the transactions as written despite the taxpayers' continuing intention to the contrary.

Several examples of reported decisions where the courts have granted relief under the doctrine of rectification, sparing taxpayers unintended tax consequences, are as follows:

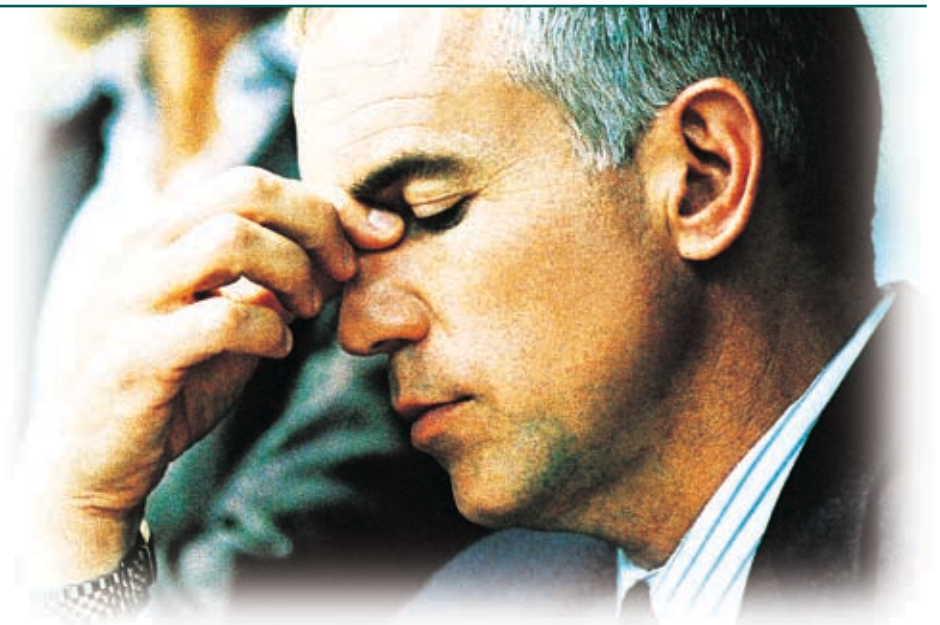
- shares unauthorized by a corporation's articles were deemed to be retroactively and validly issued in respect of a tax-deferred transaction (*Dale v. R.*, [1997] 2 C.T.C. 286 (F.C.A.));

- shares were issued in replacement of a note five years after the transaction took place in order to take into account the taxpayers' continuing intention to effect a tax-free rollover (*Juliar*);
- assignments were converted into subleases giving rise to more favourable tax treatment (*Sussex Square v. R.*, [2000] 4 C.T.C. 203 (F.C.A.)).

PROCEDURE IN ALBERTA

In Alberta the process involves making an application to the Court of Queen's Bench by originating notice with a supporting affidavit. In most circumstances, the parties to the transactions are all named as parties in the action and each will consent to the granting of the order of rectification. Rectification orders can generally be obtained at any time, whether the CRA has undertaken audit and verification activities or measures such as a reassessment.

There is some debate as to whether parties making the application for rectification need to advise the CRA of their intentions. In order to encourage disclosure to the CRA, the CRA and its counsel at the Department of Justice have established a "Rectification Committee" whose mandate is to review and advise on these applications. In public statements, the CRA has indicated that it is only in the most egregious circumstances or in the case of retroactive tax planning that it would register its opposition. Our experience has been consistent with those statements.





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

Regulatory – Energy

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
Bilinsky, Jason R.	jrb@bdplaw.com	260-0105
Campbell, Harry S.	hsc@bdplaw.com	260-0281
Cuthbertson, John H.	jhc@bdplaw.com	260-0305
Goetz, John C.	jcg@bdplaw.com	260-0110
Houston, Mark T.	mth@bdplaw.com	260-0375
Johnson, Cal D.	cdj@bdplaw.com	260-0203
Money, J. Stuart	jsm@bdplaw.com	260-0312
Olyan, Arnold H.,(Arnie)	aho@bdplaw.com	260-0249
Parrotta, Danielle M.	dmp@bdplaw.com	260-0189
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
Twa, 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.	pab@bdplaw.com	260-0216
Bell, Anthony (Tony) G.	agb@bdplaw.com	260-0328
Crump, Barry R.	brc@bdplaw.com	260-0352
Donaldson, Michael J.	mjd@bdplaw.com	260-0228
Haigh, David H.	drh@bdplaw.com	260-0135
Hayes, Shannon K.	skh@bdplaw.com	260-5713
McDonald, Daniel J.	djm@bdplaw.com	260-5724
McGillivray, Douglas A.	dam@bdplaw.com	260-0349
Millard, Robert O.	rom@bdplaw.com	260-5719
Mills, Douglas G.	dgm@bdplaw.com	260-0226
Morgan, Sonya A.	sam@bdplaw.com	260-0322
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, Editors-in-Chief

John H. Cuthbertson, jhc@bdplaw.com..... (403) 260-0305
 Douglas G. Mills, dgm@bdplaw.com..... (403) 260-0226

Energy Matters, Editor

Joan D. Bilsland, jdb@bdplaw.com..... (403) 260-5706

Energy Matters, Managing Editor

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

Contributing Writers and Researchers:

Michel H. Bourque, Danielle M. Parrotta, Heather R. DiGregorio,
 Doug S. Nishimura and John Wilson.

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 Editor.

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.