1963
*May 13, 14
Oct. 2

ST. LAWRENCE PETROLEUM LIMITED, THEODORE W. BENNETT and JAMES G. BENNETT (*Plaintiffs*) APPELLANTS;

AND

BAILEY SELBURN OIL & GAS LTD. and H. W. BASS & SONS, INC. (*Defendants*) ..... RESPONDENTS.

ON APPEAL FROM THE SUPREME COURT OF ALBERTA. APPELLATE DIVISION

Mines and minerals—Participation agreements—Right to share in net proceeds of production—Nature of participant's interest—Not registrable under The Mines and Minerals Act, 1962, (Alta.), c. 49.

The holders of two Crown leases entered into a farm-out agreement with B. Co., whereby the latter was granted the right to earn, by the drilling of a test well in accordance with the provisions of the agreement, a specified interest in the lands involved. B. Co. then entered into two similar participation agreements, one with a syndicate, whose interest was later acquired by the plaintiff company, and the other with an individual, whose interest was obtained on behalf of himself and his brother, both of whom were also plaintiffs. The defendant, B.S. Co., was the assignee of B. Co. Under the provisions of clause 10b of the agreements the company assigned to the participant "such an undivided interest in the petroleum and natural gas . . . as will, upon the said lands being operated by the Company and the production therefrom being sold . . . yield to the Participant the percentage of net proceeds of production as herein defined . . ." The plaintiffs contended that the said clause gave them an assignable interest in the lands defined in the agreements, capable of registration, and with a right to receive and sell their share of production from the lands. An action to obtain a declaration to that effect was dismissed by the trial judge and an appeal to the Appellate Division of the Supreme Court of Alberta was dismissed by a unanimous decision. The plaintiffs appealed to this Court.

Held: The appeal should be dismissed.

The essence of each agreement was that, by participating in the cost of drilling a producing well upon the lands in question to the extent of the stipulated percentage of cost, the participant would become entitled to receive the stipulated percentage of the net proceeds of production of such well. "Net proceeds of production" as defined referred to an amount of money. The intention of the whole agreement was that the operation of each well and the production and marketing of its products was to be under the sole control of the defendant. The participant had a right only to share in the money proceeds obtained either from the sale of the products by the company or from the sale by the company of the lands themselves. Clause 10b did no more than make the defendant a trustee of the

*PRESENT: Cartwright, Abbott, Martland, Judson and Hall JJ.

interest which it acquired under the farm-out agreement for the purposes of the participation agreements and the plaintiffs beneficiaries in respect of equitable interests which should be equivalent to their shares of the money proceeds of the sale of production.

The plaintiffs did not obtain, by virtue of clause 10b, an undivided interest in land capable of assignment by itself. It was an interest which was tied to an interest in the monies to be derived from the sale of production; an interest which would yield a certain percentage of a part of the income from each producing well in which the participant had participated. It would be capable of assignment only as a part of an assignment by the plaintiffs of their interest in the agreements themselves.

The plaintiffs' interest could not be registered under *The Mines and Minerals Act, 1962*. Clause 10b did not provide for a specified undivided interest in the relevant Crown leases and reservations, but for an indeterminate interest in the petroleum, natural gas, and related hydrocarbons within, upon or under the lands themselves. The interest described was such an interest as would, in certain events, yield a certain percentage of net proceeds of production from such lands. This was not a specified undivided interest in a lease as contemplated by s. 176(1) (b).

It also followed that the plaintiffs were not entitled under clause 10b to obtain and market a portion of the actual production of a well.

APPEAL from a judgment of the Appellate Division of the Supreme Court of Alberta[1], dismissing an appeal from a judgment of Milvain J. Appeal dismissed.

S. J. Helman, Q.C., and *R. R. Neve,* for the plaintiffs, appellants.

J. M. Robertson, Q.C., for the defendant, respondent, Bailey Selburn Oil & Gas Ltd.

The judgment of the Court was delivered by

MARTLAND J.:—By two letter-agreements dated May 18, 1951, and accepted respectively on June 28, 1951, and August 20, 1951, Seaboard Oil Company of Delaware and the British American Oil Company Limited, who were the lessees under two Crown leases, Nos. 76745 and 76746, in respect of lands located in the Buck Lake area in the Province of Alberta and who had applied to have the natural gas rights formerly comprised in Reservations Nos. 531 and 532 reserved from other disposition pending the drilling of a well on the land comprised in the leases, granted to A. G. Bailey Co. Limited and Great Plains Development Company of Canada, Ltd. the right to earn,

[1] (1962), 35 D.L.R. (2d) 574.

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by the drilling of a test well in accordance with the provisions of the agreement, as to each, an undivided 25 per cent interest in the leases and in any natural gas licences that could be obtained out of the reservations.

The present litigation affects only the 25 per cent interest acquired pursuant to these agreements by A. G. Bailey Co. Ltd.

On July 15, 1951, that company entered into two similar agreements, one with St. Lawrence Syndicate and the other with Theodore W. Bennett. The interest of St. Lawrence Syndicate was later acquired by St. Lawrence Petroleum Limited, one of the appellants in this case. The interest of Theodore W. Bennett was obtained by him on behalf of himself and his brother, James G. Bennett, both of whom are also appellants.

The respondent, Bailey Selburn Oil & Gas Ltd., (hereinafter referred to as "the respondent") is the assignee of A. G. Bailey Co. Limited. The other respondent, H. W. Bass & Sons, Inc., was party to an agreement with the respondent respecting the purchase from the respondent of casinghead gas, and was made a party to the litigation by the appellants only with a view to having that agreement set aside. No other relief was claimed as against it, and it was not represented on this appeal.

The case involves the interpretation of the two agreements of July 15, 1951. In each agreement A. G. Bailey Co. Limited was described as "the Company" and the other party as "the Participant" and those descriptions will be used sometimes hereafter when referring to the contents of the two agreements.

The recitals in each agreement refer to the letter-agreements of May 18, 1951, therein and hereafter referred to as "the Farm-out Agreement" and to the lands to which they relate. They also recite that:

> . . . the Participant desires to participate with the Company in the drilling of the test well and in the further development of the said lands, upon the terms and conditions hereinafter set forth;

Clause 1 of these agreements is the definition clause and in para. (*c*) defines the phrase "Net proceeds of production" as follows:

> "Net proceeds of production" as used in this agreement and in any Schedule hereto, shall with respect to any well mean the proceeds from

the sale of the Company's share of the production therefrom after deduction therefrom of the amount of all royalties and taxes payable or required to be deducted therefrom by the Company or any other person, and the Company's cost of or (as the case may be) reasonable charges for the operation of the said well, and after deducting from the balance then remaining ten percent of such balance. Provided, however, that until the Participant has received pursuant to paragraphs 5 and/or 9a hereof an amount out of the proceeds of production from such well equal to the total of the Participant's percentage of the drilling costs actually paid by the Participant the "net proceeds of production" shall be calculated without deducting the "ten percent of such balance" last above referred to. Where such well is, after being placed on production, operated by some person other than the Company, the Company's costs of the operation of such well shall include not only the Company's proportion of the operating costs, but also a reasonable fee to cover operational supervision and management of the Company's share of the production therefrom or proceeds from the sale thereof.

Clause 2 provides as follows:

The Company shall in accordance with the provisions of the Farm-out Agrement drill the test well and shall subject to the provision of the Farm-out Agrement conduct all operations, including production operations, at the test well in accordance with good oil field practice and in compliance with the laws of the Province of Alberta and regulations and orders enacted and passed thereunder by any competent body, and shall take production from the said lands to the full extent allowed by government regulations and consistent with good oil field practice and market conditions, and all of such operations shall be under the Company's exclusive management, control and direction, except as otherwise provided by the Farm-out Agreement.

Clause 3 provides that the Participant shall contribute to the drilling costs of the test well, the percentage of such costs set forth in Schedule "3" to the agreement. The relevant portions of that schedule provide:

In respect of Test Well:

Participant's percentage of net proceeds of production from test well	20%
Participant's percentage of drilling costs	20%
Amount of first contribution to drilling costs	$15,000.00

Clauses 3, 4 and 4a then go on to provide for the method of payment of the Participant's share of the costs and the consequences which arise from the failure to pay the same when required.

Clause 5 provides:

Subject to the provisions hereinbefore contained, in the event of production being obtained in the test well, the Participant shall be entitled to receive the percentage of net proceeds of production from the said well set forth in Schedule "3" hereto.

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Clause 6 provides that the Company shall be the sole judge of the character, necessity and extent of the expenses for the drilling and operating of the test well.

Clause 7 provides:

> On or before the last day of each month the Company shall render to the Participant a statement for the preceding calendar month showing all expenditures for which the Company shall have a right to reimbursement and as to which it shall not then have been reimbursed, and showing also the volume of production of petroleum and natural gas and the income from such products and their derivatives, calculated as herein provided, and the amount if any payable to the Participant for such month, together with a cheque for such amount.

Clause 8 gives to the Participant the right to examine the Company's books of account in reference to operations at the test well at intervals of not less than thirty days.

Clause 9 provides for participation by the Participant in further wells which might be drilled upon the leased lands to the extent of the percentage provided in Schedule "3".

Clause 10 gives to the Company the right to grant other rights of participation so long as they do not interfere with the rights of the Participant under the agreement.

Clause 10a provides as follows:

> If the Company shall make any disposition of any of the said lands with respect to the development of which the Participant would at time of disposition thereof have been entitled to participate pursuant to the combined operation of the provisions of paragraphs 3, 4 and 9 of this Agreement (other than a disposition pursuant to numerical paragraph 10 hereof), then the Participant shall be entitled to receive such percentage of ninety per cent of the net proceeds actually received by the Company from such disposition, as is equivalent to the Participant's "percentage of net proceeds of production" as fixed by Schedule C hereof.

Clause 10b will be recited in full later as it is the interpretation of that clause which is the main issue in these proceedings.

Clause 11 provides that the agreement should be subject to the terms and provisions of the reservations, leases, statutes and regulations applicable thereto and to the terms and provisions of the Farm-out Agreement or any more formal Farm-out Agreement substituted therefor.

Clauses 12 and 13 deal with the method of making payments under the agreement by the Company to the Participant.

The subsequent clauses of the agreements are not relevant to the issue in this appeal.

I now revert to clause 10b which provides as follows:

> Subject to the underlying Agreements and subject to the obtaining of any required consent, the Company hereby assigns to the Participant such an undivided interest in the petroleum and natural gas and related hydrocarbons other than coal within upon or under the said lands as will, upon the said lands being operated by the Company and the production therefrom being sold all as in this Agreement provided yield to the Participant the percentage of net proceeds of production as herein defined specified in numerical paragraph 5 hereof. The Company agrees to hold its interest in the said petroleum natural gas and related hydrocarbons in trust for the purposes of this Agreement and the Participant agrees to reassign to the Company from time to time all or such portion of the Participant's said undivided interest as may be necessary to revest such interest in the Company insofar as the same relates to any portion of the said lands in which the Participant ceases by virtue of numerical clause 4 or 9 hereof, to be entitled to a share in the net proceeds of the production therefrom.

It is the contention of the appellants that this clause gives to them an assignable interest in the lands defined in the agreements, capable of registration, and with a right to receive and sell their share of production from the lands. They brought this action to obtain a declaration to that effect. The position of the respondent is that under clause 10b the appellants acquired no more than a limited equitable interest, by way of charge, to secure to them the money payments to which, as a matter of contract, they might become entitled under the provisions of the agreements. The respondent contends that the appellants' participation in production from the lands is limited to the receipt of the prescribed portion of the proceeds of sale of production by the respondent.

The learned trial judge agreed with the respondent and dismissed the action. At the trial the appellants, contending that the provisions of clause 10b were ambiguous, tendered, subject to objection, extrinsic evidence to support their interpretation of it. The learned trial judge held this evidence to be inadmissible, but went on to hold that even if it had been admissible, his decision would have been the same.

The appellants appealed to the Appellate Division of the Supreme Court of Alberta. Their appeal was dismissed by a unanimous decision of that Court. It is from that judgment that the present appeal is brought.

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At the conclusion of the argument by counsel for the appellants, counsel for the respondent was advised that it would not be necessary for him to deal with the issue of the admissibility of the extrinsic evidence. This Court agreed with the view of both the Courts below that clause 10b, while presenting difficulties of interpretation, was not ambiguous and that the evidence was inadmissible. Counsel for the respondent was also advised that he would not have to argue the question of equitable estoppel which had been raised in the pleadings by the appellants' reply.

The sole issue remaining, therefore, is as to the meaning and effect of clause 10b.

I have reviewed the contents of the two agreements of July 15, 1951, in some detail because clause 10b must be considered in relation to and as a part of each agreement considered as a whole. The essence of each agreement is that, by participating in the cost of drilling a producing well upon the lands in question to the extent of the stipulated percentage of cost, the Participant would become entitled to receive the stipulated percenage of the net proceeds of production of such well. "Net proceeds of production" as defined clearly refers to an amount of money. They are the proceeds from the sale of the Company's share of the production from the well after making those deductions which are provided for in clause 1(*c*). The Company's share of production referred to in this para. (*c*), is, obviously, the 25 per cent interest in production which it could earn under the terms of the Farm-out Agreement. The appellants are, therefore, entitled, as a matter of contract, to a percentage of certain monies to be obtained from the sale of the production from any well in respect of whose drilling costs they have contributed their required portions.

The Company, under clause 2, is to conduct all operations regarding the well, save as otherwise provided in the Farm-out Agreement, and it is to take the production from the lands to the full extent permitted by Government regulations, good oil field practice and market conditions.

Clause 7 provides for the furnishing of monthly statements by the Company to the Participant showing income from the products and their derivatives, the amount payable to the Participant for such month, together with a cheque for such amount.

Clause 10a enables the Company to dispose of lands in respect of which the Participant would have had a right of participation upon payment to the Participant of the stipulated percentage of 90 per cent of the net proceeds of such sale.

All of these provisions are consistent only with the Company being in complete control of its interest in the lands acquired pursuant to the Farm-out Agreement, with a right in the Participant only to share in the money proceeds obtained either from the sale of the products by the Company or from the sale by the Company of the lands themselves.

It is against this background that clause 10b must be interpreted. Under its provisions the Company presently assigns *such* an interest in the petroleum, natural gas and related hydrocarbons other than coal within, upon or under the lands in question as *will*, after production is obtained by the Company's operations and sold, yield to the Participant his percentage of the net proceeds of production from the lands. In my opinion this clause says that the Participant is to have an interest in the petroleum, natural gas and related hydrocarbons equivalent to the percentage of monies constituting the net proceeds of production which he is entitled to receive under the agreement. The purpose of the clause is apparently to provide that the monies to which the Participant becomes entitled under the agreement represent the proceeds of the sale of products in which he has an equivalent interest.

The interest created by this clause, however it may be defined, is only an equitable interest, because the clause goes on to provide that the Company shall hold its interest in the petroleum, natural gas and related hydrocarbons in trust for the purposes of the agreement.

I would, therefore, construe the clause as doing no more than to make the respondent a trustee of the interest which it acquired under the Farm-out Agreement for the purposes of these agreements and to make the appellants beneficiaries in respect of equitable interests which should be equivalent to their shares of the money proceeds of the sale of production.

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I agree with the conclusion stated by the learned trial judge in the following terms:

> I cannot see that the parties contemplated or agreed to the Participant becoming owner of a fractional interest in the said lands capable of assignment and registration. Had it been intended to convey such an interest it would have been a very simple thing to do in plain and unmistakable words. The effect of Clause 10b cannot do more than confer some intangible equitable interest in the lands occupied by a producing well in which the Participant has participated.

The appellants have not obtained, by virtue of clause 10b, an undivided interest in land capable of assignment by itself. It is an interest which is tied to an interest in the monies to be derived from the sale of production; an interest which will yield a certain percentage of a part of the income from each producing well in which the Participant has participated. In my opinion it would be capable of assignment only as a part of an assignment by the appellants of their interest in the agreements themselves.

The appellants' interest could not be registered under *The Mines and Minerals Act, 1962,* (Alta.), c. 49.

Section 176(1) of that Act permits the registration of a transfer with respect to an agreement in these terms:

> 176. (1) A transfer with respect to an agreement that the lessee is not prohibited from transferring or agreeing to transfer by any provision of this Act or any regulation or by the terms of the agreement, may be registered by the Minister if the transfer conveys
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> (*a*) the whole of the agreement,
>
> (*b*) a specified undivided interest in the agreement, or
>
> (*c*) a part of the location contained in the agreement.

"Agreement" is defined in s. 2(1)(*a*) as follows:

> "Agreement" means any lease, licence, reservation, permit or other agreement made or entered into under
>
> (i) this Act or the former Act, or
>
> (ii) The Provincial Lands Act or the Dominion Lands Act and relating to a mineral,
>
> but does not include a unit agreement under Part VIII;

Clause 10b does not provide for a specified undivided interest in the relevant Crown leases or reservations, but for an indeterminate interest in the petroleum, natural gas, and related hydrocarbons within, upon or under the lands themselves. The interest described is such an interest as will, in certain events, yield a certain percentage of net proceeds of production from such lands. This, in my view, is cer-

tainly not a specified undivided interest in a lease as contemplated by s. 176(1)(*b*).

Finally it also follows that the appellants are not entitled under clause 10b to obtain and market a portion of the actual production of a well. The intention of the whole agreement, including clause 10b, is that the operation of each well and the production and marketing of its products is to be under the sole control of the respondent.

For these reasons, I would dismiss the appeal with costs.

Martland J.

Appeal dismissed with costs.

Solicitors for the plaintiffs, appellants: Helman, Fleming & Neve, Calgary.

Solicitors for the defendant, respondent, Bailey Selburn Oil & Gas Ltd.: Fenerty, Fenerty, McGillivray, Robertson, Prowse, Brennan & Fraser, Calgary.