October 14, 2011

Accounting issues left unresolved in split title litigation

By Nigel Bankes

Cases Considered:
Anderson v Amoco Canada Oil and Gas Co, 2011 ABCA 268

The Court of Appeal has finally brought an end to the phase gas, split title litigation known under the style of cause of *Anderson v Amoco*. The Court did so (at the behest of the petroleum owners (the defendants)) under the cover of the drop dead rule of the old Rules of Court. As a result of this decision the accounting issues, one of the key issues in split title litigation which has been around since the Privy Council's decision in *Borys v CPR*, [1953] AC 217, will remain unresolved. While this dismissal will bind the particular plaintiffs listed in this litigation it will not preclude disgruntled gas owners from returning to the fray in the future – either individually or as part of a class action. Thus, while the defendants and their lawyers may have cracked open a few bottles of champagne last week to celebrate the end of this long-running litigation I am not sure that the accounting issues related to production from split title lands are going to go away.

What was this case about on the merits?

The litigation dealt with ownership and accounting issues in relation to phase gas production from split title lands. Split title lands for these purposes are lands for which there are separate natural gas and petroleum titles. Gas owners filed eighty four separate law suits alleging that the petroleum owners (or their lessees) were producing evolved gas owned by the gas owners. Evolved gas is gas that comes out of solution in the reservoir principally as reservoir pressure changes over the course of production. Twenty one of these actions were selected as test cases and for these Chief Justice Moore set out two preliminary questions of law:

(a) the ownership of hydrocarbons produced from a well drilled on Split Title Lands (as defined below) and the respective rights of:
    (i) the Petroleum Owner (the party owning petroleum, or coal and petroleum within or under the Split Title Lands); and
    (ii) the Non-Petroleum Owner (the party owning all mines and minerals except petroleum, or coal and petroleum, within or under the Split Title Lands); and
(b) the obligation of any lessee to account to the owner of the respective mineral interest for hydrocarbons produced.

It is important to emphasize that notwithstanding the fact that part (b) of Chief Justice Moore's question specifically referred to accounting, the accounting issues were not argued before any level of Court in the first phase of the litigation which ultimately ended up before the Supreme Court of Canada: *Anderson v Amoco Canada Oil and Gas*, 2004 SCC 49, [2004] 3 SCR 3. That

Court answered the ownership questions based on conditions in the reservoir at the time that the documents creating the split title\severed estate were executed (i.e. original reservoir conditions). The Court held as follows (at para 42):

(a) The petroleum owner is entitled to all hydrocarbons which were in liquid phase at initial pool conditions, regardless of the phase they are in when recovered.
(b) The non-petroleum owner is entitled to all hydrocarbons which were in gas phase at initial pool conditions, regardless of the phase they are in at time of recovery.

This division will apply to hydrocarbons which migrate from under other lands, subject of course to any regulatory mitigation of the rule of capture.

The trial judge (Justice Fruman) had also decided, (1999) 63 Alb LR (3d) 1, that natural gas dissolved in connate water was also owned by the petroleum owner but the Court of Appeal noted (2002), 5 Alb LR (4^{th}) 54 at para 53 that this could not be the case since by statute (*Water Act*, RSA 2000, c W-3) all water in Alberta, including presumably connate water, is vested in the Crown. This issue was not pursued before the Supreme Court: 2004 SCC 49 at para 13.

The Supreme Court of Canada also made one other important ruling in the case when it concluded (at para 39) that the rule of capture did not apply *across* the phases of hydrocarbons i.e. the petroleum owner could not claim to be the *owner* of any natural gas under original reservoir conditions (i.e. gas cap gas) which it captured in the ordinary course of operations.

Accordingly, while *Borys* decides that the owner of the petroleum cannot be enjoined from producing the petroleum just because some gas cap gas (or condensate) is also produced, neither *Borys* nor *Anderson* allows the petroleum owner to claim ownership of gas cap gas or condensate by virtue of capture. This set of findings sets up a claim for an accounting (and possible tortious action) - at least to the extent that the petroleum owner is reducing the gas owner's gas or condensate to possession and marketing it for its own account.

The questions might include the following:

1. Does the petroleum owner owe a duty to account for monies received from the sale of gas cap gas or condensate?
2. Does the gas owner have a tortious cause of action against the petroleum owner or its lessees in relation to the above? If so, what cause of action – conversion, trespass to chattels, the ubiquitous tort of negligence?
3. What costs (if any) incurred by the petroleum owner and its lessees in drilling and operating the wells and transporting and processing of any gas cap gas or condensate should be taken into consideration as part of any accounting? Could this result in negative accounts and a duty to contribute? See *Prism Petroleum Ltd v Omega Hydrocarbons Ltd*, [1994] 6 WWR 585 (AB CA) and Justice Fruman at trial, *supra* at paras 167 – 169.
4. Does the petroleum owner (and its lessees) have a duty not to flare the gas owner's gas where such can reasonably be avoided?
5. How should onus of proof issues be dealt with? Should the Court attempt to level the playing field between the vulnerable gas owner (shades of fiduciary duty here *Frame v Smith*, [1987] 2 SCR 99 – but surely no duty of undivided loyalty) and the all powerful petroleum lessee? Should the petroleum owner have a duty to provide the gas owner with basic information about the reservoir such as information on original reserves in place,

6. original reservoir pressure and the bubble point? Should there be a duty to provide updated information from time to time? What might be the legal basis of such duties?

These are all matters which cannot now be resolved by the *Anderson* case.

So what did the Court of Appeal decide?

In its most recent ruling the Court of Appeal (Justices Martin, Picard and O'Ferrall) has simply decided to confirm Justice Nation's oral reasons (May 25, 2010) and Order (30 June 2010) dismissing the plaintiffs' actions on the basis of Rule 244.1(1) of the old Rules of Court. This Rule, the drop dead rule, provides that the Court must dismiss an action where the plaintiff has failed to take any action to materially advance the action for five years or more.

In the present case the Supreme Court handed down its judgement on July 16, 2004. Nothing was done until 2007 when there was a meeting between counsel to identify remaining issues. Ultimately the plaintiffs sought and obtained an order for the appointment of a case management justice on April 30, 2009 - but the plaintiffs did not actually apply to have a case management justice named until October 28th 2009 (after the five years had elapsed).

Following earlier authority, Justice Nation concluded that the plaintiffs had not met the requirements of the Rule to actually advance the litigation in a material way within the five years. It was not enough to take a procedural step (bringing the application for case management) – something material was required such as, in this case, actual directions from the case management justice. This never happened.

The petroleum owners have clearly won two battles - whether there is a war still left to be fought remains to be seen.