September 9th, 2009

# Williston Wildcatters: bluster no substitute for reasons and yet another judicially created leave and licence

**By Nigel Bankes**

**Cases Considered:**

*Montreal Trust Co v. Williston Wildcatters Corp.*, 2009 SKCA 85

Over the last decade we have seen litigation in both Saskatchewan and Alberta on the question of how to calculate damages where an operator continues to produce hydrocarbons on a dead lease. The Alberta case is *Lady Freyberg v. Fletcher Challenge Oil and Gas*, 2007 ABQB 353 (on the damages issue - following 2005 ABCA 46 on the lease validity issue). This matter has been settled on a confidential basis and unfortunately we cannot expect to see an appeal judgement on the damages question. I say "unfortunately" because the trial judgement seems to have proceeded on the basis that the continued production was tortious; but there is at least some ground for thinking that the operator's activities were continued with the permission of a co-owner. If that is correct, then the co-owner/lessor's claims should have been dealt with on the basis of a co-owner's claim for an accounting of more than a just share received, rather than on the basis of tort (trespass or conversion). The *Freyberg* decision is the subject of lengthy comment by Chris Simard et al, "*Lady Freyberg*: Examples of How Contemporary Courts in Alberta Approach the Modern Business Realities of the Freehold Petroleum and Natural Gas Lease" (2009), 46 Alberta Law Review 299.

The Saskatchewan case is *Williston Wildcatters*. I commented on some of the earlier proceedings in this matter in an extended case comment published in the Saskatchewan Law Review: "Termination of an Oil and Gas Lease, Covenants as to Title, and Assessment of Damages for Wrongful Severance of Natural Resources: A Comment on *Williston Wildcatters*" (2005), 68 Sask. L. Rev. 23 – 77. It seems safe to say that my comments had absolutely no impact on the subsequent course of the litigation.

To cut a long story short, the Saskatchewan Court of Appeal in *Williston* in successive judgements on lease validity (2002 SKCA 91), and damages (2004 SKCA 116), found that when the lessee continued to produce upon the expiration of the lease it was initially a tortfeasor, but, after a certain point in time, it remained on the lands by leave and licence. Ultimately, the lessee continued in possession based upon a consent order put in place following the trial judgement and pending the outcome of the appeal (and so as to permit the property to continue to be produced). The consent order (reproduced in full below) also provided that production monies

(minus a 12.5% royalty and reasonable costs of production) should be paid into trust pending the outcome of the appeal. Based on the above analysis of the status of the "lessee"/operator in each of the three periods, the Court of Appeal in its damages decision ordered that compensation should be paid to the lessor along the following lines. First, with respect to the period of tortious production, compensation (damages) should be based upon a royalty of 18% (rather than the original 12.5% reserved by the dead lease) plus a bonus payment of $6,400 (both representing the going rate in the area). The Court explicitly rejected the lessor's claim that damages should be based on proceeds of production minus the lessee's costs of production. Second, for the leave and licence period, compensation should be based on the assumed terms of the licence (i.e. a continuation of the original 12.5% royalty). Finally, there was the period during which production continued on the basis of the consent order (of which more later).

The Court of Appeal's judgement on the damages issues should have settled matters but there were some outstanding questions with respect to the monies paid into trust pursuant to the consent order granted after trial. This took the parties back before the courts, Justice Gerein at first instance (2007 SKQB 411) and, ultimately, back before the Court of Appeal for a third time (the subject of this post). Two matters seem to have been contentious. The first matter related to a gross overriding royalty (GOR). The operator in this case (Long Riders), initially claimed its working interest by virtue of a farmout of the lease rights in return for a GOR payable to the farmor (TDL). TDL claimed a share of the proceeds paid into trust.

On the application for directions, Justice Gerein seems to have decided that it was "fair and equitable" that TDL should continue to receive a GOR during the period of the leave and licence. The Court of Appeal rejected that argument. The Court of Appeal took the view that the GOR died with the death of the original lease. There was no GOR payable under the terms of the leave and licence or while production continued pursuant to the consent order. Thus, while TDL was entitled to retain monies actually paid to it under mistake, it was not entitled to any of the monies paid into trust. I think that the Court of Appeal is correct on this point. TDL can only claim a share of production if it can show that the production is subject to its royalty interest. Since its royalty interest was carved out of the lease, its royalty interest came to an end with the lease. This was not a case in which the royalty payor has in some way acted fraudulently to terminate the lease in order to take free and clear of the royalty interest. The only puzzle is why it seems to be almost taken for granted that Long Riders cannot recover the royalty already paid under mistake.

The second matter related to the respective entitlements of the lessor and the "lessee"/operator based on the terms of the consent order. The consent order provided as follows:

> (a) … [Long Riders] shall pay to its solicitors to be held in trust and invested by them on behalf of the parties who are eventually adjudged to be entitled to them all funds presently held by The Long Riders Rig Corporation or its agent to the credit of T.D.L. Petroleums Inc. and/or Fast Trucking Service

Ltd., which represent T.D.L. Petroleums Inc.'s royalty share from January 1996 to September 5, 2001 and Fast Trucking Service Ltd.'s participant share from March 1999 to September 5, 2001, in respect of production from the well at LSD 11-8-4-33 W1 (the "Well"), together with any interest which has accumulated on such funds;

(b) The Defendant, The Long Riders Rig Corporation, shall continue to pay to Montreal Trust Company the amounts payable to it pursuant to the terms of a 1952 lease in issue in the within actions;

(c) Except for amounts paid in accordance with paragraph 1(b) of this Order, the Defendant, The Long Riders Rig Corporation, shall pay into Court to the credit of the within actions all proceeds of production of the Well realized after September 6, 2001, less any reasonable costs of production in respect of those proceeds;

(d) With respect to the proceeds of production paid into court in accordance with paragraph 1(c) of this Order, the Defendant, The Long Riders Rig Corporation, will be entitled to deduct, and the Plaintiff shall not claim back, any reasonable production costs incurred by The Long Riders Rig Corporation after September 6, 2001, subject only to the Plaintiff's entitlement to argue whether such costs of production are reasonable;

(e) Nothing in clause 1(d) is to be taken as precluding the Plaintiff from claiming that the Defendants are not entitled to compensation for costs or expenses incurred prior to September 6, 2001, in respect of the Well, nor the Defendants from arguing that they are entitled to a reasonable profit for operating the Well;

(f) For production at the Well from September 6, 2001, to the conclusion of the within actions, the Plaintiff will be precluded from arguing that the Defendant, The Long Riders Rig Corporation, is liable in trespass, provided however that should any party seek to cease production of the Well or to have production of the Well cease, it must give the other parties 10 days' prior written notice of its intention to do so; and

(g) The Defendant, The Long Riders Rig Corporation, shall through its solicitors provide to the Defendant's solicitors on a monthly basis a record of monthly production at the Well and costs claimed by The Long Riders Rig Corporation in respect of that production. [emphasis added]

On the order for directions, Justice Gerein took the view that during the third period (production pursuant to the terms of this consent order), the position of Long Riders had materially changed. It now continued in possession neither by virtue of the lease nor by virtue of the leave and

licence, but by virtue of the consent order (at para. 29): "The Long Riders Group acquired a new interest by reason of the order which contemplated that it would continue to operate the well." Furthermore Justice Gerein considered that the Order did not deal completely with the distribution of revenues:

> [30] It provides that the plaintiff will be paid in accordance with the 1952 lease which means a royalty of 12.5%. It also provides that The Long Riders Group is entitled to reasonable costs of production. While it alludes to profits being realized by The Long Riders Group it neither affirms that it will be paid or how it is to be calculated. The fair and reasonable way to resolve this deficiency is for them to receive from the gross revenue an amount equivalent to what they received in the past.
>
> [31] …. In a sentence, the plaintiff obtains all the revenue realized after November 2, 2001, less the working share [i.e. the costs of production] payable to The Long Riders Group.

In effect, during this third period, Justice Gerein ruled that the lessor would be entitled to production revenues minus operating costs.

The Court of Appeal, however, took exception to this interpretation of its decision on liability/damages and took the view that Justice Gerein had effectively amended its damages award by giving the lessor more than a 12.5% royalty. It accepted the idea that there were three relevant periods to consider but took the view that it had dealt with each of these periods in its damages judgement, and in doing so it had completely disallowed any claim by the lessor to compensation on the basis of the net proceeds of production and that therefore, even for the period in which the consent order was operative (i.e. after the leave and licence had expired and when the lessor was entitled to the benefit of judgement that the lease had terminated) the lessor was only entitled to its 12.5% royalty and the balance must be paid to Long Riders.

In order for this conclusion to hold water one would expect to see in the Court of Appeal's damages judgement some discussion of each of the three periods. In particular, one would expect to see some fairly detailed discussion of the terms of the consent order and the precise basis on which the award would proceed. For example, we might have expected the court to note that damages\compensation should not be awarded on the basis of tort since paragraph (f) and the consent order generally must preclude a claim on the basis of tort. Similarly, since production was occurring by consent we might expect an inquiry into the terms of the consent. Was Long Riders perhaps a contract operator? Was consent on the terms of the original lease or on the terms prevailing in the region (the terms of the leave and licence?) Or if there was no clear agreement on the terms, should Long Riders be entitled to something like a quantum meruit?

But if we go back to the damages decision we find a detailed discussion of the first two periods, but there is no discussion whatsoever of the period covered by the consent order. Furthermore, the matter is not even listed as one of the issues at para. 17 of the judgement on damages.

In short, I understand and agree with the Court of Appeal's reasoning as it applies to the leave and licence period. That matter had clearly been decided by the Court of Appeal in its earlier decision on damages. But it is not clear that the Court of Appeal had also addressed its mind (at that time) to the period covered by the consent order and the precise basis on which production was continuing. By failing to address the issue in its damages judgement, and by refusing on appeal in this case on the request for directions to examine and construe the consent order, the Court of Appeal has effectively created its own "leave and licence" to cover the period of the consent order, and it is a leave and licence that is extraordinarily favourable to the operator! Perhaps the Court was embarrassed when it realized that it had not fully addressed period three in its earlier judgement; but that is no reason for throwing sand in the air and effectively saying "of course we addressed this in our earlier judgement". Bluster is no substitute for reasons.