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Clean-up Liability for Wells in the Mackenzie Delta

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Case Commented On: *ConocoPhillips Canada Resources Corp and Shell Canada Limited*, 2019 ABQB 727 (CanLII)

Gulf, Conoco's predecessor, undertook exploratory drilling in the Mackenzie Delta in the 1970s including the seven wells referenced in this case, most particularly the I-37 well. The wells had sump pits for the disposal of drilling waste and fluids. In 1973 Gulf obtained approval to suspend the I-37 well and fill the top two thousand feet of casing with diesel fuel. Gulf subsequently abandoned the I-37 well in the mid-1980s, installing a cement plug, but by then the diesel oil (at para 29) "was no longer in place". "All of the well sites received final clearance under the *Territorial Lands Use Regulation*, CRC, Vol XVIII, c 1524, p 13645, ss 18, 33(5), 37 in September, 1986. This approval meant that the site had been satisfactorily reclaimed and the regulator was satisfied that the conditions of the land use permit had been met." (at para 29) Prior to abandonment Gulf had used the data from these wells to procure significant discovery licences (SDL) under the terms of the *Canada Petroleum Resources Act*, RSC, 1985, c. 36 (2nd Supp) for some of its properties.

In 1991 Gulf decided to divest itself of its interest in certain SDLs including the SDLs associated with the subject wells and ultimately entered into a purchase and sale agreement (PSA) with Shell in December 1991. The evidence suggested that Gulf did not inform Shell of the disappearing diesel in the course of finalizing the PSA. It subsequently became clear (2004 onwards) that there were problems with a number of wells and sumps in the Delta and in particular with the I-37 well.

The principal issue before Master Hanebury related to the interpretation of the PSA: in particular, had Gulf transferred the wells and sumps and any liability associated with those wells and sumps to Shell as part of the "Assets" referenced in the PSA. The definition of "Assets" in the PSA included Petroleum and Natural Gas Rights (PNG rights) and Miscellaneous Interests. Conoco took the view that the wells were included within one or other branch of this definition.

The PSA defined PNG Rights as "the entire interest of the Vendor [Gulf] in and to the Leases to the extent applicable to the Lands…in Schedule A" (at paras 146 – 147). "Leases" in turn were defined as "leases, licences, permits and other documents of title, including, without limitation, farm-out, operating, participation, royalty, pooling and unit agreements, set forth…in Schedule 'A'…by virtue of which the holder is entitled to drill for, win, take, own or remove the leased substances within upon or under the Lands". Master Hanebury notes (at para 148) that "Schedule A sets out each SDA [significant discovery area], each SDL, the governing contract, the operator and the depth of the interest. It does not specifically refer to the wells." While the definition does not explicitly refer to wells she concluded (apparently endorsing Conoco's submissions) that they could be included implicitly. The following paragraphs set out her reasoning:

> [161] Conoco relies on the concept of *profit à prendre* to argue that the wells can be included in the definition of P&NG rights by implication. A *profit à prendre* is the right to come onto an estate, in this case the land, and capture or take a resource.
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> [162] Both parties acknowledge that an SDL is a *profit à prendre*: *Orphan Well Association v. Grant Thornton Ltd*., 2019 SCC 5 (CanLII), 2019 SCC5, para. 11; *Alberta Energy Co. v. Goodwell Petroleum Corp*., 2003 ABCA 277 (CanLII), para. 63.
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> [163] Conoco says that as the wells were a necessary requirement for the granting of an SDL, they are a part of the *profit à prendre*, and therefore implicitly included in the transfer of the SDLs. It points out that a well is a fixture and the industry practice is that as such it is annexed to the interest of the operator: *Montreal Trust Co. v. Williston Wildcatters Corp.,* 2004 CarswellSask 583, para's 134-143. Gulf was both the operator and an owner of the wells in issue.
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> [164] Shell responds that the wells, as they had no licences or regulatory documentation of ownership, do not meet the requirements for a *profit à prendre*.
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> [165] The case law provided by the parties does not indicate that a well licence is a prerequisite to a *profit à prendre.* The SDLs related to the wells in issue remained in place and had not been surrendered or revoked, with the result that there were continuing associated rights. In *Orphan Wells* the Supreme Court of Canada noted that companies will "often hold *profits à prendre* in both producing and unproductive or spent wells." This indicates that an abandoned well, where the well is still *in situ*, can support a *profit à prendre*.
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> [166] As a result, I agree that the abandoned wells, despite the absence of a regulatory ownership regime at that time, and not being explicitly part of the P&NG rights, were assets that could be of use in the future subject to regulatory approval, and as part of a *pofit à prendre (sic)* were implicitly included in the definition of P&NG rights.

With respect this may go too far. To qualify for inclusion as a Lease there must be a document of title. A physical well, whatever it is, is not a document of title. Even if Canada had a system of well licences or authorizations at the time (which apparently it did not), such a licence would not be a document of title (or a *profit à prendre*) but rather an administrative licence to do that which without the licence would be a breach of a statutory prohibition.

The PSA defined "Miscellaneous Interests" as the entire interest of Gulf:

> … in and to all property, assets and rights, *other than Petroleum and Natural Gas Rights*, to the extent pertaining to the Petroleum and Natural Gas Rights and the Lands to which Vendor is entitled as the date hereof, including without limitation, the entire interest of the Vendor in all contracts, agreements, and documents, including geological, geophysical, seismic and engineering reports…to the extent that they relate to the

> Petroleum and Natural Gas Rights…including all subsisting rights to enter upon, use and occupy the surface of any of the Lands… (at para 168; emphasis added)

Reframed, that meant that the wells could be included in the definition only if they were property pertaining to the PNG rights. Master Hanebury concluded that the wells fell "within the usual meaning of property" – which seems reasonable. Equally, they *pertained* to the PNG assets since:

> In this case the wells and the sumps were integral to the granting of the SDL and, while abandoned, remained in place with the possibility of re-entry. Conoco suggested that their re-use could occur as a result of a desire to protect the Arctic environment from further drilling. In any event, they had a possible future use and were a "back-up asset". Unlike {other cases] …. the wells remained available for possible future use. Furthermore, in my view it would be difficult to argue that they do not pertain to the SDL lands as they are affixed to the lands … (at para 175)

Having concluded that the wells could fall with the definition of Assets on either of these two bases (and it must be one or the other and not both since a Miscellaneous Interest is something "other than Petroleum and Natural Gas Rights"), Master Hanebury then turned to look at the PSA as a whole, and then the commercial context to see if her preliminary view was consistent with the balance of the agreement. As for the agreement considered as a whole, Master Hanebury confirmed that other provisions of the PSA supported her interpretation. In particular, clause 18 on Liabilities and Indemnities (quoted, but only in part, in para 180) provided that Shell was buying the Assets on an "as is" basis, and that Shell would hold Gulf harmless from environmental liabilities "including without limitation, damage from or removal of hazardous or toxic substances, clean up, well abandonment and reclamation, attributable to or relating to the Assets or any of them, whether or not such liability accrued prior to or subsequent to the Effective Date." In Master Hanebury's words:

> … this detailed indemnity arrangement and the agreement to buy the assets on an "as is where is" basis only makes sense if the wells are included in the definition of Assets. (at para 185)

I will not review Master Hanebury's detailed consideration of the evidence related to context (and post execution conduct). Suffice it to say that Master Hanebury identified nothing in the context that would allow the interpreter to infer that the wells and sumps were to be excluded from transfer under the PSA.

On the main issue therefore, Master Hanebury concluded that Conoco was entitled to a declaration that Shell is the owner of the wells and sumps. The request for a declaration was not time barred since a declaration is not a remedial order and as such is not covered by the *Limitations Act*, RSA 2000, c L-1. Other elements of relief requested by Conoco including a claim for specific performance however were time barred. Finally, this was not a case in which Conoco's application for a declaration should be barred by the doctrine of laches.

Master Hanebury went on to consider Shell's application to file a counter-claim (which she dismissed) but I will not analyse that set of issues here.

Conclusion

The intentions of the parties as revealed in the documents pertaining to the transfer and in the surrounding circumstances suggest that both parties understood that, with some very limited exceptions that were not triggered here, Gulf was divesting itself of all liability for these SDLs including any associated wells and sumps. This intention is most convincingly revealed and explained on the basis that the wells and sumps were property pertaining to the PNG rights (i.e. part of the Miscellaneous Interests basket). The argument that the wells and sumps should be included in the term Assets through the definition of PNG rights as "documents of title" is unconvincing.

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