1968
*Nov. 1
1969
Jan. 28

SINCLAIR CANADA OIL COMPANY (*Plaintiff*) ..... APPELLANT;

AND

PACIFIC PETROLEUMS LIMITED (*Defendant*) ..... RESPONDENT.

ON APPEAL FROM THE SUPREME COURT OF ALBERTA, APPELLATE DIVISION

Contracts—Interpretation—Agreements entered into by oil development companies—Whether appellant had contractual right to share in payment made by third company to respondent.

Under an agreement dated December 31, 1951, an oil company (Act) assigned its interests in certain petroleum and natural gas permits, which included four permits hereinafter referred to as "the Act Permits", to the respondent. Act's right to convert a 25 per cent carried interest into a 25 per cent participating interest not having been exercised within the time provided for in the agreement, *i.e.* on

PRESENT: Martland, Judson, Ritchie, Hall and Spence JJ.

or before August 1, 1953, the position of the parties, under the agreement, was that the respondent was assignee of all of Act's interest in the permits described in the agreement, including the Act Permits, and that Act was entitled to a 25 per cent interest in the gross proceeds of sale of production of all leased substances produced and marketed from all wells drilled on lands covered by the assigned permits after deduction of the payments and costs made by the respondent, as described in the agreement.

Under an agreement, dated January 22, 1954, between A Co. (the respondent's predecessor in title) and S Co. (the appellant's predecessor in title), S Co. acquired from A Co. the latter's right to enter upon certain projects (as defined in the agreement) to carry on exploratory and development work thereon for oil and gas substances. Included in these projects were lands covered by the Act Permits, as well as other lands.

A further agreement (*i.e.* "the Amendatory Agreement") was made between A Co. and S Co. on December 11, 1954. Instead of agreeing to expend the sum of $5,000,000 in an 18-month period, as provided in the agreement of January 22, 1954 (*i.e.* "the Basic Agreement"), S Co. agreed to spend $10,000,000 during a period of 4½ years. Instead of having to wait for the obtaining of commercial production from a project, to earn a 50 per cent interest in the project, S Co. acquired immediately a 25 per cent interest in all the projects, with the right to obtain an additional 25 per cent interest in any project from which commercial production was obtained. S Co. agreed to waive its right of recoupment of acquisition costs.

After the making of the Basic Agreement and the Amendatory Agreement, Act approached the respondent with a view to obtaining a renewal of the right which it had had, under the 1951 agreement, and which had expired before the Basic Agreement was made, to convert its carried interest under the 1951 agreement into a working interest. On July 31, 1956, an agreement was made between Act and the respondent which permitted this right to be exercised by Act, and it was, in fact, exercised by Act by notice dated June 1, 1962. Upon being notified by the respondent of the proposed revival of Act's conversion right, S Co. not only consented to the revival of this right, but expressed its willingness to forgo any claim for exploration costs recovered from Act if the conversion were effected by Act.

Following the conversion of its carried interest into a working interest, Act paid to the respondent the amounts stipulated in the 1951 agreement, which related to all of the permits referred to in that agreement, including the Act Permits. The appellant, successor in title to S Co., had incurred total expenditures of $1,868,620.15 in relation to the Act Permits. It claimed from the respondent the whole of the payment of $467,155.04 made to the respondent by Act, which represented 25 per cent of the expenditures made in relation to the Act Permits, this being the amount which Act was required to pay to the respondent for the privilege of exercising the right of conversion.

An action brought by the appellant to enforce its claim was dismissed at trial and an appeal from the trial judgment was dismissed by the Appellate Division of the Supreme Court of Alberta. On appealing to this Court the appellant abandoned its claim for the full amount of $467,155.04, which had been based on a claim for unjust enrichment. It contended that it was entitled to recover either: (1) $132,855.13,

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representing 25 per cent of the moneys paid by Act to the respondent, on the basis that it had acquired a 25 per cent interest in these moneys, pursuant to the provisions of the Amendatory Agreement; or (2) $205,194.45, representing the amount referred to in (1), plus an additional 25 per cent of the payment by Act in respect of a permit on which the appellant had completed a commercial well on April 24, 1958, as a result of which it claimed to have acquired an additional 25 per cent interest in that payment.

Held: The appeal should be dismissed.

There was nothing in the contractual arrangements existing between the appellant and the respondent (reference being made to the appellant and the respondent as though they were the actual parties to the Basic and the Amendatory Agreements, rather than the successors in title) upon which a claim to share in the payment made by Act to the respondent could be founded. That payment was made by virtue of contractual arrangements between Act and the respondent to which the appellant was not a party. Each of the alternative claims submitted by the appellant in this Court was dependent upon the appellant's establishing a contractual right to participate in the payment made by Act to the respondent, and, in the Court's opinion, no such contractual right existed.

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

D. P. McLaws, Q.C., and *R. S. Dinkel*, for the plaintiff, appellant.

R. A. MacKimmie, Q.C., and *G. W. Lade*, for the defendant, respondent.

The judgment of the Court was delivered by

MARTLAND J.:—By an agreement in writing (hereinafter referred to as "the Act Agreement") dated December 31, 1951, made between Act Oils Limited (hereinafter referred to as "Act") and the respondent, Act agreed to assign to the respondent all of its estate, right, title and interest in certain British Columbia Crown Petroleum and Natural Gas Permits held by Act, which included permits numbered 38, 86, 90 and 98 (hereinafter referred to as "the Act Permits").

Clause 6 of the Act Agreement provided as follows:

6. CARRIED INTEREST OF ACT

The Permits assigned to Pacific under the provisions of this Agreement shall be held by Pacific in trust for Act as to an undivided Twenty-

[1] (1968), 67 D.L.R. (2d) 519.

five per cent (25%) net carried interest, being a Twenty-five per cent (25%) share or interest in the gross proceeds from the sale of production of all leased substances hereafter produced, saved, recovered and marketed from all wells drilled on any of the lands from time to time hereafter covered by the Permits assigned to Pacific under the terms of this Agreement after there shall have been deducted therefrom firstly the cash consideration paid by Pacific to Act as hereinbefore provided, secondly, all costs and expenses incurred by Pacific in the acquisition and maintenance by it of its interest in Permits Nos. 38 and 98 under the said Agreement dated the 8th day of November, A.D. 1950, determined in accordance with the provisions thereof, thirdly all costs and expenses, including Royalty, determined in accordance with the Scheduled Accounting Procedure hereto annexed as Schedule "B" and the further provisions hereof, incurred by Pacific in the exploration, drilling, development and operation of all the lands from time to time comprised within the Permits and the maintenance of the Permits in good standing.

Clause 8 of that agreement provided that the respondent should be the Operator of all lands comprised within the assigned permits.

Clause 12 of the agreement gave to Act the right, upon giving to the respondent 30 days' notice, at any time prior to August 1, 1953, to convert its 25 per cent net carried interest, as provided for in cl. 6, into a 25 per cent participating interest. It went on to provide as follows:

> Upon converting its interest aforesaid, Act shall pay to Pacific twenty-five per cent (25%) of all those costs and expenses which Pacific shall be entitled to recover out of the entire gross proceeds of sale of production prior to disbursing any moneys to Act in clause 6 hereof, calculated as of the expiration of such thirty (30) day period. From and after such date Act shall furnish its proportionate share of all costs and expenses for the maintenance, development and operation of the lands covered by the Permits assigned to Pacific under this Agreement and the provisions of the next succeeding clause hereof shall thereupon be and become operative in lieu of and in substitution for clauses 6 and 7 hereof, and Pacific shall stand possessed of the Permits in trust for itself and Act as to all its rights and interests thereunder and all production of leased substances from the lands covered thereby and all wells and equipment thereon in the following proportions, namely:—
>
> Pacific 75%
> Act 25%

This right was not exercised by Act within the time limited by cl. 12. After that time had expired, the position of the parties, under the Act Agreement, was that the respondent was assignee of all of Act's interest in the permits described in the Act Agreement, including the Act Permits, and that Act was entitled to a 25 per cent interest in the gross proceeds of sale of production of all leased substances produced, saved, recovered and marketed from

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all wells drilled on lands covered by the assigned permits after deduction of the payments and costs made by the respondent, as described in cl. 6.

This was the situation when an agreement in writing, hereinafter referred to as "the Basic Agreement", dated January 22, 1954, was made between Canadian Atlantic Oil Company, Ltd., hereinafter referred to as "Atlantic", and Southern Production Company, Inc., hereinafter referred to as "Southern". The appellant is the successor in title to Southern, and the respondent is the successor in title to Atlantic.

Article I of the Basic Agreement defined various words and terms used in the agreement. Paragraph 1 of this Article provided:

1. Where the word "Project" is used it shall mean, subject to the selection provided for in Schedule C hereof with respect to Projects B-4 and B-7 those tracts of land identified by Schedules A and B, and designated on one of the two maps by the corresponding number, and shall include the oil and gas substances within, upon, or under such lands and all rights, titles, and interests granted under or resulting from the reservations, permits, licenses, leases, deeds and grants pertaining thereto or concerning any part thereof, including renewals or extensions thereof;

Article II set out the covenants of Atlantic as follows:

ARTICLE II
COVENANTS OF ATLANTIC

1. Atlantic undertakes and warrants that it is entitled to enter in or upon the Projects and to carry on Exploratory Work and development work thereon for oil and gas substances.

2. Atlantic undertakes and warrants that Southern shall have the right, subject to the provisions of and, for any term of, this Agreement, to enter upon the Projects as listed in Schedules A and B and to carry on Exploratory Work and development work in the same manner and with the same rights as if such work was carried on by it. With respect to the Projects, Atlantic will endeavor to make such right of Southern exclusive.

3. Except as otherwise specifically provided with respect to Projects A-2, A-7 and B-7 in Schedule C annexed hereto and made a part hereof, upon Southern completing the first Commercial Well on any Project, Atlantic will assign and convey to Southern an undivided one-half of its right, title and interest in such Project and will enter into an Operating Agreement substantially in the form hereto attached as Schedule D, providing for the joint operation and development of the Project. One or more separate Operating Agreements will be entered into for each Project.

Southern agreed to spend, during the period from January 1, 1954, to June 30, 1955, the sum of $5,000,000 in performing the obligations required to be performed by Atlantic under the terms of the various reservations,

licences, permits, leases, deeds and grants to maintain Atlantic's rights in the projects and in performing such exploratory works as Southern might determine on such of the projects as Southern might select. Included in the projects described in the agreement were the lands covered by the Act Permits, as well as other lands.

It was agreed that Southern would be the operator of the defined projects, and provision was made for the recovery by Southern, from production, of its costs and expenses. This provision was contained in art. VI of the Operating Agreement which was annexed to the Basic Agreement.

A further agreement, hereinafter referred to as "the Amendatory Agreement", was made between Atlantic and Southern on December 11, 1954. The major changes effected in the Basic Agreement by the Amendatory Agreement were as follows:

1. Instead of agreeing to expend the sum of $5,000,000 in an 18-month period, as provided in the Basic Agreement, Southern agreed to spend $10,000,000 during a period of 4½ years, from January 1, 1954, to June 30, 1958.

2. Instead of having to wait for the obtaining of commercial production from a project, to earn a 50 per cent interest in the project, Southern acquired immediately a 25 per cent interest in all the projects, with the right to obtain an additional 25 per cent interest in any project from which commercial production was obtained.

3. Southern agreed to waive its right of recoupment of acquisition costs, retroactive to the date of the Basic Agreement. "Acquisition Costs" were defined in the Amendatory Agreement as including "all exploratory work and any and all rentals payable under the terms of the Basic Agreement, as amended, plus direct and overhead costs to Southern as provided in the Basic Agreement".

The Amendatory Agreement also provided that art. VI of the Operating Agreement, previously mentioned, which provided for Southern's recovery of costs and expenses from production, should be deleted. All of the amending provisions in the Amendatory Agreement were made retroactive to and effective as from January 1, 1954.

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It was subsequent to the making of the Basic Agreement and the Amendatory Agreement that Act approached the respondent with a view to obtaining a renewal of the right which it had had, under the Act Agreement, and which had expired before the Basic Agreement was made, to convert its carried interest under the Act Agreement into a working interest. On July 31, 1956, an agreement was made between Act and the respondent which permitted this right to be exercised by Act, and it was, in fact, exercised by Act by notice dated June 1, 1962.

Before this amending agreement was made, Southern had been notified by the respondent of the proposed revival of Act's conversion right. No objection was taken by Southern, and, in fact, by its letters to the respondent, dated March 6, 1956, and May 11, 1956, Southern not only consented to the revival of this right, but expressed its willingness to forgo any claim for exploration costs recovered from Act if the conversion were effected by Act.

Following the conversion of its carried interest into a working interest, Act paid to the respondent the amounts stipulated in the Act Agreement, which related to all of the permits referred to in the Act Agreement, including the Act Permits. The appellant, successor in title to Southern, had incurred total expenditures of $1,868,620.15 in relation to the Act Permits. It claimed from the respondent the whole amount of the payment of $467,155.04 made to the respondent by Act, which represented 25 per cent of the expenditures made in relation to the Act Permits, this being the amount which Act was required to pay to the respondent for the privilege of exercising the right of conversion.

Before this Court the appellant abandoned its claim for the full amount of $467,155.04, which had been based on a claim for unjust enrichment. It did contend that it was entitled to recover either:

(1) $132,855.13, representing 25 per cent of the moneys paid by Act to the respondent, on the basis that it had acquired a 25 per cent interest in these moneys, pursuant to the provisions of the Amendatory Agreement; or

(2) $205,194.45, representing the amount referred to in para. (1) above, plus an additional 25 per cent of the payment by Act in respect of permit 38, on which the

appellant had completed a commercial well on April 24, 1958, as a result of which it claimed to have acquired an additional 25 per cent interest in that payment.

In respect of the submissions made by the appellant in this Court, the primary issue to be determined is whether, under the terms of the Basic Agreement and the Amendatory Agreement, the appellant has any contractual right to recover from the respondent either of the amounts which it now claims. For the purpose of greater clarity I will be referring to the appellant and the respondent as though they were the actual parties to these agreements, rather than successors in title.

The appellant's contention is that, by the terms of those agreements, the respondent assigned to the appellant a 25 per cent interest, not only in the oil and gas substances underlying the lands described in the agreements, but also an undivided 25 per cent interest in any benefits to be derived by the respondent pursuant to the various instruments by which the respondent held its interest in such oil and gas substances, and that, by accepting such assignment, the appellant assumed, in addition to its obligations under the Basic Agreement, an undivided 25 per cent of the obligation of the respondent contained in such instruments.

The granting clause, contained in the Amendatory Agreement (amending cl. 3 of art. II of the Basic Agreement), provides that:

> Immediately and upon the execution and delivery of this Agreement, Southern will be entitled to receive from Atlantic and Adherents, and Atlantic and Adherents will assign and convey to Southern an undivided one-fourth of their respective interests in the Projects, as defined in the Basic Agreement and in the Schedules attached thereto.

The definition of the word "Project" is contained in para. 1 of art. I of the Basic Agreement, which has already been quoted.

In my opinion, this definition covers certain tracts of land, described in the schedules A and B, and, specifically, oil and gas substances within, upon or under those lands. When the clause goes on to refer to "rights, titles, and interests granted under or resulting from the reservations, permits, licences, leases, deeds and grants *pertaining thereto*" it is referring to rights, titles and interests in oil and gas substances derived from such instruments. The

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words "pertaining thereto", which I have italicized, relate back to the words "oil and gas substances". The granting clause, therefore, refers to an assignment of a one-fourth interest in the assignor's interest in oil and gas substances in certain tracts of land, as derived from various instruments.

The schedule to the Basic Agreement, when referring to those projects with which we are here concerned, refers to a permit "Subject to Act's 25 per cent net carried interest", or "Act 25 per cent carried". What was assigned in respect of those projects was, therefore, one-fourth of the respondent's interest in the oil and gas substances underlying the lands described in the Act Permits, which interest was subject to the 25 per cent net carried interest of Act, as defined in cl. 6 of the Act Agreement.

That clause, previously quoted, defined the carried interest as a 25 per cent share in "*the gross proceeds from the sale of production* of all leased substances" produced and marketed from wells drilled on the lands described in the permits. Before Act became entitled to share in such proceeds, certain deductions were to be made, as defined in this clause.

The appellant's submission is that the assignment of the 25 per cent interest contained in the Amendatory Agreement assigned to it an undivided 25 per cent of the respondent's right to recover moneys from Act under that clause and that, consequently, when the right to convert was revived and Act made a money payment to the respondent to effect such conversion, its right continued and applied to those moneys. I do not agree with this contention. Clause 6 of the Act Agreement did not create a right to recover money from Act. It created, in favour of Act, a carried interest in the proceeds of sale of oil and gas substances. It is true that in computing the amount of money which Act would be entitled to receive, provision was made for the prior deduction from gross proceeds of sale of certain expenditures. It is also true that, to the extent of such deductions, the balance remaining, initially to the respondent, and, after the making of the Basic Agreement and the Amendatory Agreement, to the respondent and to the appellant, would have been that much the greater. But any benefit accruing to the appellant, if cl. 6 had remained operative, and no conversion had been

effected by Act, was not by virtue of any assignment to the appellant of a right to recover money from Act. Such benefit would have accrued indirectly and only because it had an interest in the oil and gas substances and the proceeds of their sale determined after deducting therefrom the amount of Act's carried interest. What the appellant got as a result of the assignment was a 25 per cent interest in the respondent's interest in the oil and gas substances underlying the tracts described in the projects. In the case of the Act Permits, what it got was 25 per cent of the whole interest in those permits, less Act's carried interest, as defined in cl. 6.

It is my opinion, therefore, that at the time the Basic Agreement and the Amendatory Agreement were made, the appellant had not acquired by assignment any right to receive moneys payable by Act. Furthermore, since prior to the making of the Basic Agreement the right to convert by Act had ceased to exist, the appellant did not acquire, by virtue of the Basic Agreement and the Amendatory Agreement, any right to share in moneys which might be paid by Act in order to exercise its right of conversion.

The renewal of Act's conversion right was effected after the Amendatory Agreement had been made, with both the knowledge and the consent of Southern, the appellant's predecessor in title. The appellant did not stipulate for any share in the payment to be made by Act in order to exercise that right. On the contrary, Southern stated its willingness to forgo any claim thereto.

In the result, I can find nothing in the contractual arrangements existing between the appellant and the respondent upon which a claim to share in the payment made by Act to the respondent could be founded. That payment was made by virtue of contractual arrangements between Act and the respondent to which the appellant was not a party.

The foregoing reasoning applies equally to each of the alternative claims submitted by the appellant in this Court, for $132,855.13 and for $205,194.45 respectively. Each claim is dependent upon the appellant's establishing a contractual right to participate in the payment made by Act to the respondent, and, in my opinion, no such contractual right exists.

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In view of the conclusion reached in respect of the submissions made on this point, in this Court, it is unnecessary to determine whether, in any event, the appellant's claim would be defeated by virtue of the appellant's waiver of its right to recoupment of acquisition costs, as provided in the Amendatory Agreement, or on the basis of contract or estoppel arising from the exchange of correspondence between the respondent and Southern.

In my opinion the appeal should be dismissed with costs.

Appeal dismissed with costs.

Solicitors for the plaintiff, appellant: McLaws & Company, Calgary.

Solicitors for the defendant, respondent: MacKimmie, Matthews, Wood, Phillips & Smith, Calgary.