**Stoney Tribal Council v. PanCanadian Petroleum Limited**

# IN THE COURT OF APPEAL OF ALBERTA THE COURT: THE HONOURABLE MADAM JUSTICE McFADYEN THE HONOURABLE MR. JUSTICE SULATYCKY THE HONOURABLE MADAM JUSTICE RAWLINS BETWEEN: STONEY TRIBAL COUNCIL, REPRESENTING THE CHIEFS, COUNCILS AND MEMBERS OF THE BEARSPAW, CHINIKI AND WESLEY BANDS Respondent (Plaintiff) -and- PANCANADIAN PETROLEUM LIMITED Appellant (Defendant) -and- THE ATTORNEY GENERAL OF ALBERTA Intervenor -and- CHEVRON CANADA RESOURCES Applicant (Intervenor) APPEAL FROM THE JUDGMENT OF THE HONOURABLE MR. JUSTICE McINTYRE DATED THE 9TH DAY OF APRIL, 1998 MEMORANDUM OF JUDGMENT

**COUNSEL:**

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| A. D. Hunter, Q.C. | | | For the Appellant |
| K. E. Staroszik | J. O'Reilly | W. T. Osvath | For the Respondent |
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MEMORANDUM OF JUDGMENT

**SULATYCKY, J.A.:**

[1] The respondent, Stoney Tribal Council (the "Stoneys"), sought a declaration that "TOPGAS" financing charges and operating, marketing and administration charges ("OMAC") were not deductible from the Bearspaw, Chiniki and Wesley Bands' ("the Bands") natural gas royalties owed by the appellant, PanCanadian Petroleum Ltd. They sought an accounting, in effect, a re-calculation of the royalties due to the Bands and a judgment for the unpaid amounts over the limitation period applicable to the claim.

[2] The judgment of McIntyre J., dated April 9, 1998, found the Stoneys entitled to recalculation of royalties without deduction of OMAC and TOPGAS financing charges and repayment from May 3, 1983. The principal sum amounted to $3,432,696.00.

**ISSUES**

1. Is the applicable limitation 6 years or 10 years?
2. Were the TOPGAS and OMAC charges properly considered in computing the royalties?

FACTS

[3] Briefly, by way of background, the royalties in dispute are payments on gas produced from the Stoney reserve lands. The statutory framework applicable to the production of petroleum products on the Stoney reserve is federal, since the federal government has exclusive jurisdiction over Indians and land reserved for Indians: s. 91(24) of the *Constitution Act, 1867*, R.S.C. 1867, App. II, No. 5. Federal legislation, primarily the *Indian Act*, R.S.C. 1985, c. I-5, establishes a scheme for the regulation of Indian lands.

[4] Section 37(2) of the *Indian Act* requires that reserve lands be surrendered to the federal Crown before they may be leased or an interest in the lands granted. There were eight surrenders of portions of reserve land made by the Stoneys between 1926 and 1962. The surrenders provide that they are "in trust to lease" the lands for the benefit of the Stoney Band.

[5] This dispute involves four mineral leases. One lease is dated February 1, 1973 and its replacement is dated December 1, 1982. Another lease is dated April 1, 1975 and its replacement is dated April 1, 1985. They each provide that a royalty shall be paid as prescribed in the regulations. Further, the two earlier leases provide that the royalty shall be "free and clear of all rates and taxes and assessments and from all manner of deduction whatsoever".

[6] The applicable regulations, the *Indian Oil and Gas Regulations*, C.R.C. 1978, c. 963 and SOR/81-340 (" *IOGR* "), were originally made in 1977 and amended in 1981 pursuant to the *Indian Oil and Gas Act*, R.S.C. 1985, c. I-7 and its predecessors. Those regulations set out how the royalty is to be calculated.

[7] Section 21(1) of the regulations provides:

> 21(1) Except as otherwise provided in a special agreement under subsection 5(2) of the Act, the royalty on oil and gas obtained from or attributable to a contract area shall be the royalty computed in accordance with Schedule I, as amended from time to time, and shall be paid to Her Majesty in right of Canada in trust for the Indian band concerned.

[8] Schedule I of the *IOGR* provides:

> 2(2) The royalty to be computed, levied and collected on gas obtained from or attributable to a contract area shall comprise the basic royalty of 25 per cent of the gas obtained from or attributable to the contract area plus the applicable supplementary royalty determined in accordance with subsection (3), all quantities to be calculated at the time and place of production free and clear of any deduction whatever except as provided under subsection (4).
>
> . . .
>
> 2(4) Where gas is processed by a method other than gravity, the royalty on the gas obtained therefrom shall be calculated on the actual selling price of that gas, but such costs of processing as the Manager may from time to time consider fair and reasonable, calculated on the total of the basic and the supplementary royalty portion of production, shall be allowed.
>
> 2(5) For the purposes of this section , "actual selling price" means the price at which gas is sold or the price specified pursuant to subsection 21(7) of these Regulations, whichever is greater.

[9] The main dispute in this appeal arises out of the application of Alberta provincial legislation to the calculation of the royalties on gas taken from the Stoney reserve lands. There are differences between the royalties on Indian land and the royalties on non-Indian land. The Stoneys argue that those differences include the non-application of provincial regulations.

[10] Some history of the Province of Alberta's scheme of gas regulation is required to explain the provincial legislation in issue in this appeal, and how it relates to the facts of this case.

[11] PanCanadian sold the gas produced from the Stoney lands to Trans-Canada Pipe Lines Limited ("TCPL") under long-term agreements which included take-or-pay requirements. In overly simple terms, a take-or-pay agreement provided that a buyer had to buy a certain quantity of gas within a specified period from a producer. If that quantity was not taken, the purchaser had to pay for it in any event. That payment entitled the buyer to call for delivery of the untaken gas out of future production. However, TCPL did not incur any pay provisions in respect of gas produced from the Stoney lands because it always took the full amount required. But its experience with take-or-pay agreements in general was not favourable.

[12] TCPL, in response to a perceived future shortage of gas in the early 1970s, aggressively contracted for gas. By 1976-77, they had an over supply and as a consequence, incurred substantial costs under contracts with take-or-pay clauses. To pay those costs, TCPL borrowed money.

[13] In 1977, the Alberta Petroleum Marketing Commission decided that TCPL's financing costs for its take-or- pay obligations could be included in the Alberta Cost of Service ("ACOS"). The ACOS was defined in the *Natural Gas Pricing Agreement Act*, S.A. 1975, c. 38. It was part of the calculation of the regulated field price, the amount paid to producers. The ACOS was regarded as a cost attributable to the acquisition of gas and therefore, was deducted from the regulated field price. That price was the basis upon which PanCanadian calculated its royalty obligations. Put another way, royalties were calculated after TCPL deducted the interest charges it paid on the loan which financed its take-or-pay obligations.

[14] TOPGAS financing charges refers to the repayment of interest by the producers who were party to the " TOPGAS agreements". TOPGAS agreements were two agreements made in 1982 and 1993 among TCPL, its holding company TOPGAS Holdings Limited and the majority of gas producers. It did not include the Stoneys nor the Department of Indian Affairs and Northern Development, the federal department responsible for managing oil and gas on Indian lands. The two agreements rearranged the obligations among the parties so that TCPL's future take-or-pay

obligations were substantially reduced and the producers were no longer obliged to deliver prepaid gas. Under the agreements, the producers owed repayment obligations and the TOPGAS financing charges were the repayment of the interest.

[15] Decisions of the Alberta Petroleum Marketing Commission permitted the inclusion of TOPGAS financing charges in the ACOS.

[16] In May 1986, after gas prices were deregulated, the National Energy Board ("NEB") recommended that all Alberta gas going into the TCPL pipeline system bear part of the TOPGAS financing charges. The charges were to be collected as a surcharge, not included as part of the ACOS. The NEB's decision did not consider whether the surcharge applied to Indian land mineral leases. The collection of the TOPGAS charges were legislated in Alberta by the *Take-or-Pay Costs Sharing Act*, S.A. 1986, c. T-0.1. That act provides for a "levy" payable on gas upon its delivery within Alberta to TCPL.

[17] OMAC charges refer to an amount for the marketing and administrative services of the gas marketing subsidiary of TCPL which became responsible for marketing after November 1, 1986. The 1986 Netback Pricing Agreement among TCPL and its producers set prices. The netback price was determined after all revenues were placed in a pool, OMAC and other charges were deducted, and the remaining amount was divided by the total amount of gas sold. Further amounts, including TOPGAS charges, were deducted from the netback price to arrive at the contract price, the amount to be paid to producers. The 1986 agreement was replaced by a similar agreement in 1988.

[18] The Stoneys brought their claim arguing that the *Take-or-Pay Costs Sharing Act*, the TOPGAS financing charges and the OMAC charges do not apply to the calculation of royalties on Indian lands and therefore, they are entitled to an accounting and judgment for the amount of the unauthorized deductions.

[19] The claim was filed May 3, 1993.

**LIMITATION PERIOD**

[20] The trial judge held a royalty was an interest in land. Section 1(e) *Limitation of Actions Act*, R.S.A. 1980, c. L-15, defines "land" as including an interest in land. He held that s. 18(a) of the *Limitation of Actions Act*, which sets 10 years as the limitation for "proceedings to recover land", applied. He also held that there was a breach of contract and therefore, s. 4(1)(c) which sets a limitation period of 6 years for the recovery of money on a contract also applied. The Stoneys were entitled to pick the longer limitation period.

[21] We find the limitation period applicable to this claim is 6 years, not 10.

[22] This particular claim is not properly characterized as a proceeding to recover an interest in land. This can be determined simply by looking at the pleadings. In their Amended Statement of Claim, the Stoneys do not seek to recover the royalty itself. The first basis for their claim is contract. Paragraph 6 pleads:

> The Plaintiff states that the monies paid by the Defendant on the sale of the Bands' Royalty Gas has been significantly less than what is provided for under the terms of the mineral leases. The said underpayment arises by reason of the Defendant making or allowing unauthorized deductions from the selling price of the Royalty Gas. . . .

[23] The other causes pleaded in the claim were breach of trust, breach of fiduciary duty and unjust enrichment. None of these can be regarded as an action to recover an interest in land.

[24] Under the terms of the leases, the Stoneys could have elected to take their royalty in kind, but they elected not to do so and nothing in their pleadings suggests that the claim is for recovery of the royalty interest. The relief claimed in the Amended Statement of Claim is for an accounting and judgment in the sum of all royalty monies due to the Bands by reason of any unauthorized deductions or alternatively, an accounting for all part payments received by the Band from the gas buyers relating to contracts to market or sell gas obtained from the reserve lands and judgment for the royalty portion of such part payments. On that basis, alone, we would find that the applicable limitation period cannot be s. 18(a).

[25] The only authority which has held that an interest in solution gas to be produced from a well was an interest in land and therefore, a 10 year limitation applied, is the trial decision in *Prism*

*Petroleum Ltd.* v. *Omega Hydrocarbons Ltd.* (1992), 130 A.R. 114 (Q.B.). In that case, the plaintiffs were seeking, *inter alia*, an order declaring ownership to solution gas and an accounting and damages for wrongful conversion. No reasons were given by the trial judge for his conclusion that the action was for the recovery of land. The decision was overturned by this Court, at (1994), 18 Alta. L.R. (3d) 225, which made it unnecessary to address the limitation issue. The *Prism Petroleum* decision is not applicable in this case. Without deciding the correctness of the limitation issue as determined by the trial judge in *Prism Petroleum*, it is clear that, here, the Stoneys are not claiming ownership to the gas.

[26] The respondent's counsel argued that the request for an accounting and monies due is the remedy but the action was based on recovery of the royalty. He cited as authorities *Scurry-Rainbow* Oil Ltd. v. *Galloway Estate* (1993), 8 Alta. L. R. (3d) 225 (Q.B.) aff'd; (1994), 23 Alta. L.R. ( 3d) 193 (C.A.), *Scurry-Rainbow Oil Ltd.* v. *Kasha* (1996), 184 A. R. 177 (C.A.), *Denver Joint Stock Land Bank of Denver* v. *Dixon* , 122 P. 2d 842 (Wyo. S.C. 1942) (cited with approval in *Galloway, supra* ) and *Berkheiser* v. *Berkheiser* , [1957] S.C.R. 387 for the proposition that the royalty interest remains an interest in land until the royalty is paid in full. Here, he argued, the Stoneys are seeking full payment of the royalties and therefore, continue to hold an interest in land.

[27] The authorities cited by the respondent are distinguishable. In those cases, the minerals remained *in situ*. In this case, the natural gas to which the royalty interest attaches was lawfully severed and sold in accordance with the oil and gas leases. The Stoneys are not seeking to recover their royalty interest. They cannot. The gas no longer exists. What remains in issue is whether the correct amount of royalty payments were remitted.

[28] The Stoneys' counsel suggested this case was analogous to an unpaid vendor's lien. The unpaid vendor retains an interest in land until paid in full.

[29] The analogy in some ways may be apposite. But in this case, the most appropriate analogy would be with the case where the original owner has an agreement with a third party to sell the land on its behalf and receive a percentage of the sale price; the parcel of land has been sold and title has transferred, but the owner has not yet received the full percentage of the selling price. The original owner no longer has an interest in land but has an action in contract.

[30] Some support for this characterization of this action can be found in *Blueberry River Indian Band et al.* v. *Canada*, [1995] 4 S.C.R. 344. In that case, in 1916, the Beaver Band exchanged aboriginal title for reserve land in British Columbia. In 1940, it surrendered the mineral rights on the reserve land to the Crown "in trust to lease". After World War II, the reserve lands were sold to the Director of the *Veterans' Land Act* ("DVLA") to be sold to veterans for farming. New reserve lands were purchased for the Band. In the transfer to the DVLA, the reservation of mineral rights was inadvertently omitted. In 1976, oil and gas was discovered on the former reserve lands. The revenues went to the veterans. In 1978, after a Department of Indian Affairs officer discovered the accidental loss of mineral rights, the successors to the Beaver Band commenced an action claiming damages against the Crown for the improvident surrender and also claimed damages for permitting the transfer of the mineral rights to the DVLA. The Federal Court trial judge dismissed the claims except for the sale of surface rights but held that the action was barred by the 30 year limitation under the British Columbia *Limitation Act*. The majority of the Federal Court of Appeal dismissed the appeal.

[31] At the Supreme Court of Canada, McLachlin J. (as she then was) addressed the issue of the applicable limitation. Under the British Columbia act, the ultimate limitation period is 30 years, 10 years for breach of trust and 6 years for actions not listed. There is no limitation period for actions for possession of land or to enforce a *profit à prendre*. The act also provides that the commencement of a limitation period may be postponed in certain circumstances. McLachlin J., in determining the applicable limitation period, considered arguments which had not been considered below, however, she did not conclude that the claim for the lost mineral rights was a claim for the possession of land. She held at p. 403 that the transfer to the DVLA was an alienation of title which converted the Band's interest from a property interest into a sum of money. Later, she described the events as the "crystallization of the property interest into a monetary sum". She found that the 30 year limitation for breach of trust applied and that claims for the mineral rights fell within the 6 year limit for any other actions not specifically provided for. In that case, the postponement provisions applied and the limitation period did not commence to run until the material facts were within the Band's knowledge, but McLachlin J. did not find that the action was for a property interest.

[32] Similarly, in this case, any property interest has been alienated. The gas has been sold. What remains is not an action for the gas but for the correct sum of money owing under contract. The limitation period, therefore, is 6 years.

**DEDUCTION OF CHARGES**

[33] None of the parties challenge the federal government's authority to set royalty calculations or the provincial government's authority to pass the *Take-or-Pay Costs Sharing Act*. The issue is whether the *Take-or-Pay Costs Sharing Act*, and the deductions it permits, apply when calculating the royalties owing on gas produced from reserve lands.

[34] We agree with the trial judge that the TOPGAS financing charges and OMAC should not be taken into account when calculating the royalties on gas produced from the Stoney's leased lands. Those charges constitute deductions from the actual selling price which, under the *Indian Oil and Gas Act,* the *IOGR* and the Leases, are explicitly not allowed.

[35] The four leases in issue are part of the federal regime for Indian oil and gas. None of the parties challenged the depiction of the federal regime as separate and apart from the non- Indian regime. The leases expressly provide that the royalties to be paid shall be " *free and clear of all rates and taxes and assessments and from all manner of deduction whatsoever* " [emphasis added] and specifically incorporate the regulations under the *Indian Oil and Gas Act* as the prescribed manner for calculating the royalties.

[36] The calculation of royalties is prescribed in detail in the *IOGR* . Section 21(1) of *IOGR* provides that the royalty shall be computed in accordance with Schedule I. Section 2(2) of Schedule I provides that the royalty is to be 25% "to be calculated at the time and place of production *free and clear of any deduction whatever* except as provided under subsection (4)." [emphasis added] Subsection 2(4) provides, "Where gas is processed by a method other than gravity, the royalty on the gas obtained therefrom shall be calculated on the actual selling price of that gas, but such costs of processing as the Manager may from time to time consider fair and reasonable, calculated on the total of the basic and the supplementary royalty portion of production, shall be allowed." Thus, the "levy" in the *Take-or-Pay Costs Sharing Act* is expressly excluded by the terms of the leases and the incorporated regulations.

[37] PanCanadian argued that in this case the royalty was calculated in accordance with the regulations because it was based on the sale price. It argued that the sale price was the actual price at which the gas was sold. If the sale price in this case was not considered fair market value, the Manager of Indian Oil and Gas Canada ("IOGC") should have deemed a fair market value as provided under s. 21(7) of the *IOGR* which provides that the lessee must pay additional royalties if the gas is sold or to be sold at a price that, in the Manager's opinion, is less than the fair market value of the gas. The Manager must give the lessee a notice setting out the dollar value that would have been realized if the gas were "sold in a business-like manner", as at "the time and place of production in an arm's length transaction". The lessee must pay the difference between the dollar value in that notice and the dollar value from the sale. The Manager did not do so in this case.

[38] PanCanadian cited the decision of the Federal Court of Canada in *Imperial Oil Resources Ltd.* v. *Canada (Minister of Indian Affairs and Northern Development)*, [1997] 139 F.T.R. 106; affirmed [1999] F.C.J. No. 1910 (Q.L.) (C.A.), for the discussion of s. 21(7) and for that court's rejection of the decision of the Executive Director of IOGC to conduct an audit on the basis that marketing fees had been improperly deducted before calculating the royalties on gas produced from Indian reserve land.

[39] The decision in *Imperial Oil Resources Ltd.* v. *Canada* does not apply to this present appeal. In that case, Texaco Canada Resources Ltd. ("TCRL") produced gas from Indian reserve land. The gas was sold to an affiliated company, Texaco Canada Inc. ("TCI"), who agreed to market the gas products for a 5% marketing fee. Royalties paid to the Indian bands were calculated on a sale price which included the 5% deduction of the marketing fee. The Executive Director (now called the Manager) of IOGC was of the opinion that the 5% marketing fee should not have been deducted before the calculation of royalties and decided to conduct a formal audit. The decision to audit was upheld by the Minister of Indian Affairs and Northern Development. The successor the TCRL, Imperial Oil Resources Limited, sought judicial review of the Minister's decision.

[40] At the trial division, Rothstein J. held that the power of the Executive Director did not include the power to audit and therefore, quashed the Minister's decision. The decision does not turn on the merits of the deduction of the marketing fee.

[41] The reasons of the judicial reviewing judge show that the focus of the judicial review was the error of the Executive Director and the Minister in treating TCRL and TCI as one entity by regarding TCI's selling price as if it were TCRL's selling price and the 5% marketing fees as if it were an expense of TCRL, which then could not be deducted as it was not a cost of processing. He stated that he could appreciate the concern of the Executive Director and Minister that non-arm's length transactions may inappropriately reduce royalties, but in the case before him, he could see no reason to treat the affiliated corporations as one entity. Further, he found that there was no authority in the *IOGR* to pierce the corporate veil. He concluded at p. 117 that the Executive Director and Minister "do not have a power to allow or disallow costs in their discretion." He continued, "I think this anomaly makes it clear that the Regulations do not authorize the respondents to treat different corporate entities, even non-arm's length entities, as one and the same."

[42] In *obiter*, the judicial reviewing judge suggested that the proper remedy of the Executive Director, where royalty obligations were inappropriately reduced due to non-arm's length dealings, was to have deemed a fair market value as provided under s. 21(7) of the Regulations.

[43] The Federal Court of Appeal dismissed the appeal on the basis that there was no error justifying appellate intervention.

[44] The *Imperial Oil* decision does not assist PanCanadian in characterizing the TOPGAS and OMAC charges as included in the actual selling price. The *Imperial Oil* decision is limited to the finding upon judicial review that the Executive Director of IOGC erred in piercing the corporate veil in order to characterize the marketing fee. There is no issue of non-arm's length transactions in this appeal. Further, the *Imperial Oil* decision did not determine whether the deduction was properly part of the sale price nor does it limit the remedies available to only s. 21(7) of the *IOGR*, which permits the Manager or Director of IOGC to deem a fair market value.

[45] In the present appeal, we agree with the trial judge that the Take-or-Pay levy cannot be considered part of the actual selling price. PanCanadian's characterization of the charge is not borne out when the specific operation of the provisions of the *Take-or-Pay Costs Sharing Act* is considered. That Act describes the charge as a "levy." Section 2 provides that the levy is payable on delivery of gas and that the person liable for the payment is the seller. The *Take- or-Pay Costs Sharing Act* does not purport to be setting the selling price of gas or to be part of the calculation of the selling price of gas. By the terms employed in the *Take-or-Pay Costs Sharing Act*, it is an added charge on the seller. In practice, TCPL would pay PanCanadian after deducting the TOPGAS and OMAC charges which PanCanadian owed to TCPL.

[46] The charges were a separate obligation, not part of the selling price of gas. They were not permitted under the legislation regulating oil and gas production on reserve lands and they should not have been deducted before calculating the royalties owed to the Stoneys.

**SUMMARY**

[47] We find that the Stoneys are entitled to a recalculation of their royalties without the TOPGAS and OMAC charges. Their claim is limited to 6 years, therefore, the repayment of royalties is from May 3, 1987. Interest is payable pursuant to the *Judgment Interest Act*.

[48] As success has been divided the parties will each bear their own costs.

APPEAL HEARD on April 10 and 11, 2000
REASONS FILED at Calgary, Alberta, this 24th day of July, 2000

**SULATYCKY, J.A.**

I concur: **McFADYEN, J.A.**
I concur: **RAWLINS, J.**