THE NEGOTIATOR

The Magazine of the Canadian Association of Petroleum Landmen
January 2014

ANDREW BELL

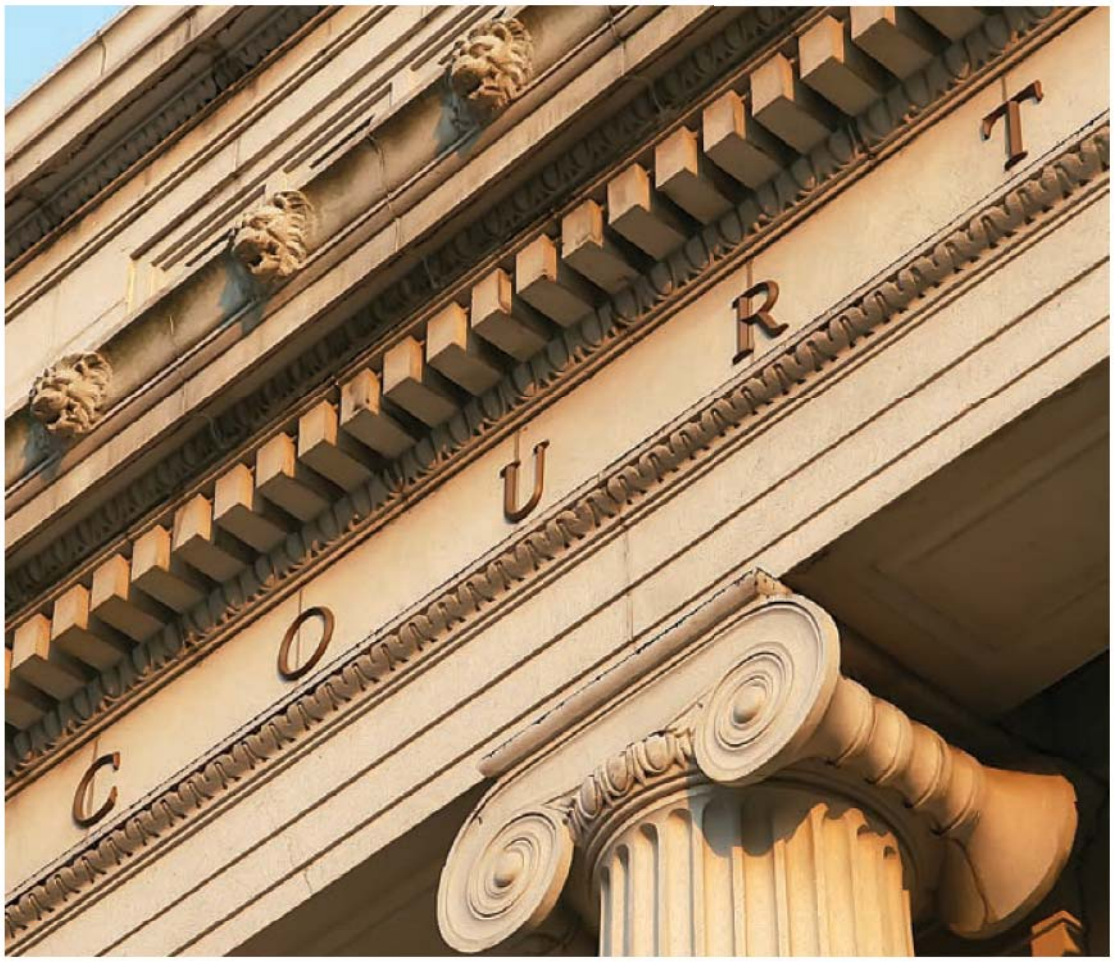
A World Running Out of Resources

CAPL MANAGEMENT NIGHT
JANUARY 15, 2014

Jensen – Redux
Limitations of Actions:
Knew or Ought to Have Known

The LLR Program
An AER Update

The Stewart Case
Testing the Validity
of a Freehold Lease



Jensen – Redux

Limitation of Actions – Knew or Ought to Have Known

THIS ARTICLE IS A FOLLOW UP TO MY SEPTEMBER 2013 *NEGOTIATOR* ARTICLE ON THE CASE OF *CANADIAN NATURAL RESOURCES LTD. V. JENSEN RESOURCES LTD.* [2012] A.J. No. 1387. A follow up is required as the Alberta Court of Appeal decision in *Canadian Natural Resources Ltd. v. Jensen Resources Ltd.* 2013 ABCA 399 overturned the trial decision on the limitations issue.

My September article started as follows

I don't like to write about limitations of action issues. Limitations is a goofy area of law that is full of odd twists and very fact specific issues. Tough to read too much into a particular case. However, the recent Alberta Court of Queen's Bench decision in *Canadian Natural Resources Ltd. v. Jensen Resources Ltd.* [2012] A.J. No. 1387 bugged me enough that you now get to hear my very special rant on this topic.

Jensen bugs me because of the way the case deals with the application of either a 2 or 10 year limitation period for lawsuits claiming damages for non-payment of an overriding royalty (GOR). Spoiler alert, the Court found that a sophisticated landman, working in the oil patch, was entitled to the softie 10 year limitation period and not the more strict 2 year period.

Don't get me wrong. I don't blame Jensen for making his claim. I have been told by several landmen I know and really respect, that Jensen is a first class landman and person. FYI, "Jensen" is not his actual name, but rather than name of his holding company that owns the GOR. His actual name is

WRITTEN BY
PAUL NEGENMAN
LAWSON LUNDELL

not important to the case. I don't like the way the Court is treating the limitation issue, but I fully understand why someone would make this claim. Heck, that is the whole point of having fancy pants litigation lawyers.

The Court of Appeal heard the appeal and released its decision in a crazy short pe riod of time. This makes my (rather loud) rant in September either: prophetic; or yet another example of how commenting on cases other than Court of Appeal cases is kinda silly. I am going with prophetic. Otherwise, I risk becoming that sort of crazy guy that no one wants to talk to at parties (or the bus stop).

Just so you don't need to look for the September article, I will restate the facts of the case and the limitations act section.

Facts

The GOR was originally granted by Kissinger Petroleum Ltd. The grantees were, I believe, a group of employees under a royalty pool program administered by Kissinger. Jensen is the successor to one such employee and is entitled to a net 0.25% GOR under the contract. The royalty payor is Kissinger, who becomes Ranger, then Petrovera and ultimately CNRL. This is the contract part of the equation.

The title document part involves a 3 section PNG lease subject to the GOR. All is good until the Crown "steals" (pardon my French) back petroleum in the Mannville from the PNG lease pursuant to Oil Sand Area Order 3. Ranger (CNRL) follows the procedure under AENR Information Letter 84-15 and applies for a "substitute oil sands agreement" for the oil sands rights carved out of the old PNG lease. For one section the Crown offered an oil sands lease ("OSL"). For the other 2 sections, the Crown offered an oil sands prospecting permit (OSPP) with specific work requirements (i.e. fresh consideration) payable by Ranger. Ranger agrees and acquires the new OSL and OSPP. The OSPP eventually becomes another OSL.

CNRL paid royalties on one section of the OSL but not the other two. This matter came to the attention of Jensen in 2007 who "happened to be working for CNRL at the time". Surprisingly, Jensen wanted a royalty on all three sections. He sued in 2009. He was a very senior landman, had the GOR agreement in his possession, had Accumap and worked at CNRL since 2003.

The Limitations Act

The Court cites the applicable section of the Alberta Limitations Act as follows:

> [58] Section 3(1) of the Limitations Act codified and refined the common law discoverability rule which provided that a cause of action arose for the purposes of a limitation period when the claimant discovered, or ought to have discovered by the exercise of reasonable diligence, the material facts upon which the claim is based. Section 3(1) states:

3(1) Subject to section 11, if a claimant does not seek a remedial order within

(a) **2 years after the date on which the claimant first knew, or in the circumstance ought to have known,**

(i) that the injury for which the claimant seeks a remedial order had occurred,

(ii) that the injury was attributable to the conduct of the defendant, and

(iii) that the injury, assuming liability on the part of the defendant, warrants bring a proceeding, or

(b) within 10 years after the claim arose.

whichever period expires first, the defendant, on pleading this Act as a defence, is entitled to immunity from liability in respect of the claim.

Knew, Or in the Circumstances Ought to Have Known

The application of the Act is simple:

- If Jensen "knew, or in the circumstances ought to have known" that its GOR might apply to the OSL, the limitation is 2 years.
- If not, he gets 10 years to sue.

At trial, the Court leaned heavily on certain comments from the Court of Appeal decision in *Meek (Trustee of) v. San Juan Resources Inc.*, 2005 ABCA 448, 376 AR 202 and adopted the following rational for allowing a 10 year limitation:

> Royalty interest holders often do not have ready access to the documentation that would enable them to determine if there is production from a particular well and whether they have been paid the royalty owing on that production. **A royalty interest holder is entitled to expect the royalty payor to honour its obligations. Absent clear information to show improper payment, royalty interest holders are not obliged to take positive steps aimed at ensuring that they are being correctly paid.** Although Imperial's new reporting procedures in 2000 made it easy to know what wells were the subject of royalty payments, Carrington did not have up-to-date information from the AEUB that would indicate what wells were in production. In other words, she did not simultaneously have the information that would enable her to put together the two critical pieces of the royalty puzzle. Nor was she obliged to procure the AEUB reports. (emphasis added [in the *Jensen* decision])

The Court of Appeal rejects this approach and takes a much more literalist approach to considering the language of the statute and the facts:

> [41] The central issue is when the respondent "knew or ought to have known" that it had a claim for unpaid royalties. The trial judge and the parties became distracted by a comment in Meek, at para. 33:
>
> > ... A royalty interest holder is entitled to expect the royalty payor to honour its obligations. Absent clear information to show improper payment, royalty interest holders are not obliged to take positive steps aimed at ensuring that they are being correctly paid. ...
>
> This passage is merely a comment on the facts in Meek. In that case, the claimants were not involved in the oil industry, did not have easy access to material information, and "ought not to have known" of their claim at an earlier time. The reference to "clear information" did not (and could not) purport to amend the wording of the Limitations Act. **The Act does not require "clear information", but rather specifies a test of when the claimant "ought to have known" of the claim. Meek at para. 21 recognized that "ought to have known" calls for "reasonable diligence" on the part of the claimant.** There will be cases where the claimant will have sufficient knowledge to throw an obligation on it to make reasonable inquiries about its rights. That will start the running of the limitation period, even if the claimant's knowledge could not be described as "clear information to show improper payment". [emphasis mine]

In my prior article, I somewhat poetically described the Court's need to choose between having claimants wear their "big boy pants" or go with "love and fairness". By choosing to require reasonable diligence by the claimant, the Court of Appeal is really saying that big boy pants win.

The reasonable diligence test is applied to our facts as follows:

> [43] [Jensen] acknowledged that he became aware between 1997 and 1999 that the royalties the respondent was receiving for section 32 were arising from an oil sands lease (discovery read-ins, p. 72, l. 19 to p. 74, l. 9; EKE A129). (The date would have to be after May 1999 when oil production started on section 32.) He therefore knew at that point in time there was oil production on section 32. At that time he also knew that the respondent had the right to receive equivalent royalties with respect to any oil production on sections 1 and 4. He had copies of the gross overriding royalty agreements, which on their proper interpretation entitled the respondent to royalties under the oil sands leases. Discoverability relates to issues of fact, not questions of law, and any difficulties in interpreting the documents does not extend the limitation period: *Luscar Ltd. v Pembina Resources Ltd.* (1994), 24 Alta LR (3d) 305 at para. 127, 162 AR 35 (CA). **In any event he had actual knowledge that those royalties were being paid under essentially the same documentation on section 32, which was sufficient knowledge to require inquiries on his part:** *Luscar* at paras. 131-3. [emphasis mine]

All is again right with the world.

Know Your Claimant

However, a strong note of caution is required in reading too much into this decision. Applying a reasonable diligence test to "ought to have known" is very fact specific. The particulars of your claimant are crucial in determining if the tougher 2 year limitation will apply. Knowledgeable and sophisticated claimants will be held to a higher standard. The Court of Appeal expresses this pretty clearly in Jenson:

> [45] [Jensen] had 40 years of experience as a landman in the oil and gas business. He and his holding company held a significant number of royalty interests (EKE A113-7). It was part of his business to manage royalty agreements on behalf of others. He had also been involved in the exploration and production of oil in the Cold Lake area for many years. He would have known that heavy oil production in that area had increased significantly.

I know landmen and solicitors like to negotiate and work things out. We don't like to sue. Seems very mean. Like calling someone a liar. Not fun.

So, big boy pants and a 2 year limitation for sophisticated individuals, and I would expect, for all oil and gas companies.

Little old lady freehold lessors getting screwed around on offset obligations or lease termination? My guess is that love and fairness will apply and ergo a 10 year and not a 2 year limitation.

A Note on Periodic Payments

The Court of Appeal nicely summarizes the rolling nature of limitations with respect to periodic payments, such as royalties payable under agreements or leases:

> [40] ...In the case of periodic payments, such as the royalty payments in question here, a separate limitation period arises with respect to each missed payment: *Meek (Trustee of) v San Juan Resources Inc.*, 2005 ABCA 448 at paras. 48-9, 52 Alta LR (4th) 1. The claimant cannot avoid the consequences of the statute by seeking a declaration that money is payable: *Joarcam, LLC v Plains Midstream Canada ULC*, 2013 ABCA 118 at paras. 5-7.

Trite law, but a nice reference point to remember that each month you fail to pay (or pay properly) is a separate breach which creates a new cause of action to sue.

When Does Your Limitation Clock Stop

The result of the above is that Jensen is only able to recover damages for a 2 year look back window from when he filed the Originating Notice in the action:

> [48] On this record, [Jensen] had sufficient information to put him on inquiry sometime after 1999. If he had made reasonable inquiries at that time, he would have discovered that there was already oil production on section 4, and it would have alerted him to the possibility of future production on section 1. The respondent ought to have known, in this time frame, that it had a claim for royalties against the holder of the oil sands leases. **The precise date need not be ascertained, because this is well before the limitation cut-off date, two years before the issuing of the Originating Notice.** In the result, the respondent is entitled to an accounting for royalties on oil production on sections 1 and 4, but only from and after September 18, 2007. [emphasis mine]

This is very, very important. The 2 year look back is triggered by the date you sue (i.e. file an originating notice or statement of claim). You are entitled to damages for 2 years prior to the filing date and thereafter until the Court renders judgement (which can be a very long time for most court cases).

I know landmen and solicitors like to negotiate and work things out. We don't like to sue. Seems very mean. Like calling someone a liar. Not fun. Better to just write emails, have meetings and get things settled.

I totally agree, but if you are the aggrieved party you must remember that the clock is ticking. During all your months of negotiating, you are losing the right to sue. This can be especially important in our industry where wells have very high initial production which declines steeply (horizontal oil wells) and where the price we receive for our product fluctuates wildly. Some sophisticated (or unscrupulous) parties might try to drag negotiations on and on. If they can get past a 2 year period, it is a great way to eliminate damage claims with respect to the earlier big boomer months when the wells were producing at a high volume or commanding a great price.

Best practise is to quietly file your claim to stop the limitation clock. No need to even serve the claim right away. I believe you get a year to actually serve the other party. That way you do not lose any of your look back damages. Not sharp practise or mean. Simply the obvious and right thing to do in the face of limitation periods.