Theories of Ownership of Oil and Gas*

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I. *The Problem of Ownership*

The discovery of petroleum and natural gas reservoirs in Western Canada has brought the practitioner many new legal problems. Of these perhaps the most basic is the problem of the ownership of oil before it is produced. Since the discovery of the first oil well in Pennsylvania a little over a century ago, the landowner has wanted to know whether he owns the oil in the reservoir thousands of feet below the surface of the land. Will his ownership be protected against his neighbour who drains the oil from neighbouring wells? As often as not his lawyer has not been of much help to him in his uncertainty. Clearly the broad principles of ownership governing stationary or visible objects are difficult to apply to a substance which migrates from one place to another before being reduced to possession.

Oil is contained in permeable rock surrounded by impervious strata and, through the eras of geological time during which it was formed, remained relatively stationary. Once the reservoir is pierced, however, and production commences, the oil percolates toward the producing area to equalize pressure. An oil well at one end of Alberta's large Leduc oil field may drain oil from the other end of the same field. As the oil migrates, it passes beneath the surface of many landowners, numbers of whom may own wells that have been drilled into the pool. Who owns the oil coming from any one well? One witness in a recent Alberta case[1] likened

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[1] *Borys* v. *Canadian Pacific Railway Company and Imperial Oil Limited*, (1951) 2 W.W.R. (N.S.) 145.

an oil zone such as the Leduc D-3 to a glass of soda pop being drained by several boys through straws. The amount each will get depends entirely on his own ability to obtain it.

For the land conveyancer the migratory nature of oil raises fundamental issues. Is it possible to convey an interest in a substance which may not be the subject of ownership until it is possessed? The disposition may be void for uncertainty. Will the conveyance of oil pass an interest in land which may be protected by an action of ejectment?

This elusive or fugacious quality of petroleum (and for this discussion we will presume that the term "petroleum" embraces both oil and gas) is not present in most minerals lying below the surface. Because it is immobile, there is little doubt who owns a given seam of coal, but a given quantity of petroleum will wander equally as unpredictably and as uncontrollably as a wild animal. The argument has been advanced that petroleum belongs to no one until it is actually reduced to possession.

The three possible answers to this problem of ownership may be seen by an examination of the case law in the United States. Canadian law is not yet well developed in many aspects of the oil industry and the number of decided cases are relatively few. In the United States, however, there exists a great bulk of case law extending back over one hundred years. This bulk results from the fact that thirty-eight of the forty-eight states are oil producing and that the American oil industry is at least as litigious as any other.

II. *American Theories of Ownership*

Today the United States cases on the concept of ownership of petroleum in the reservoir may be divided for the most part into three schools, which will be referred to as the Texas, Pennsylvania and Oklahoma theories after the names of the states in which they originated.[2]

In Texas, the interest created by a petroleum lease is held to be a separate and absolute fee simple. A surface owner with no reservations or exceptions in his title is deemed to own absolutely any oil and gas under his land; when he grants a lease or conveys a transfer of the petroleum his purchaser similarly holds a fee simple in the severed estate. The Texas courts support this theory by citing from Lord Coke the maxim *ad coelum et ad inferos*.[3]

[2] Glassmire, Oil and Gas Leases and Royalties (2nd ed., 1938) pp. 98 ff.; Summers, Oil and Gas (1927), Vol. 1, pp. 114 ff.

[3] *Cujus est solum, ejus est usque ad coelum et ad inferos:* Co. Litt.

The industry soon found opportunity to test this theory when suits were commenced by surface owners claiming compensation and damages from adjoining surface owners for draining away their petroleum. The argument was logical: if a landowner owns an absolute interest in the petroleum beneath his land, he ought certainly to be able to protect his interest against his neighbour's oil well. Although the argument was logical, the judicial answer was not; the answer was however convenient. The courts of Texas reiterated the opinion that a fee simple exists in oil and gas in the ground, but then stated that it is a "defeasible fee".[4] In other words, the owner is liable to lose his oil if someone draws it away, but until that happens his ownership is absolute. It may be that the difficulty is one of terminology, but it would seem that the qualification of a fee simple by calling it "defeasible" indicates an estate that is something less than a fee simple.

The Pennsylvania theory has been adopted in California and in the majority of oil producing states. This theory contemplates something less than a fee; ownership is not absolute until the oil is actually brought to the surface and reduced to possession.[5] Thus if the oil escapes to another's land the ownership is lost. The Pennsylvania type lease grants an incorporeal right to explore and vests title when the oil is reduced to possession. The petroleum is regarded as a chattel real, a *profit à prendre*, and is therefore an interest in land. The ownership is qualified, but is sufficient to sustain an action for ejectment, and is subject to the local rules on the disposition of real property.

The Oklahoma rule is a minority rule followed by Indiana among other states. These jurisdictions hold that there can be no ownership in oil and gas. Oil leases are there regarded merely as exclusive grants of rights to explore,[6] conveying no interest in land. The migratory feature of petroleum has caused it to be compared with animals *ferae naturae*. By analogy, oil, like an animal, cannot be owned until it is captured. Until it is reduced to possession no property interest exists in oil or animal. The Oklahoma lease therefore grants only a licence or bare personal right. The theory draws

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4a; Holdsworth, A History of English Law (1932), Vol. VII, p. 485; Richardson, Private Property Rights in the Air Space at Common Law (1953), 31 Can. Bar Rev. 117, at p. 121.

[4] *Texas Company* v. *Daugherty* (1915), 107 Tex. 226, 176 S.W. 717; *Texas Company* v. *Davis* (1923), 113 Tex. 321, 254 S.W. 304.

[5] *Westmoreland and Cambria Gas Co.* v. *DeWitt* (1889), 130 Pa. 235, 5 L.R.A. 731; *Hague* v. *Wheeler* (1893), 157 Pa. 324, 22 L.R.A. 141.

[6] *Kolachny* v. *Galbreath* (1910), 26 Okla. 772, 110 Pac. 902; *Frank Oil Co.* v. *Belleview Gas and Oil Co.* (1911), 29 Okla. 719, 119 Pac. 260.

a careful distinction between the right to the oil itself and the right to take the oil. One supporter of this theory argues that it is as logical to assert ownership of the sunbeams above the land as to assert the existence of a fee simple in migrating petroleum.

To sum up, the theories of ownership in the United States are (a) Texas—absolute ownership; (b) Pennsylvania—qualified property interest; and (c) Oklahoma—no ownership, only an exclusive right to explore.

III. *English Decisions*

The fact that some underground substances are vagrant has not been ignored in the English courts. The case of *Borough of Bradford* v. *Pickles* is an illustration.[7] The defendant, who owned land on a hill overlooking the City of Bradford, beneath which water percolated to supply the city wells, asked the city to compensate him for the use of the water. When his request was denied, he dug wells upon his own land to divert the water and prevent it from reaching the city wells. The city commenced action, claiming that the diversion of water was an actionable wrong. In the course of the reasons for judgment it was stated that a landowner does not own the water percolating under his land until he captures it.

A similar problem came before the Judicial Committee of the Privy Council in 1899 in *Trinidad Asphalt Co.* v. *Ambard*.[8] The plaintiff and defendant were adjoining owners of portions of an asphalt deposit. Asphalt is chemically similar to oil and resembles it physically as well, for it has a slight tendency to flow. The defendant here dug up the asphalt on his property up to the boundary line, leaving a recess on his side. Daily, portions of the asphalt from the plaintiff's side of the boundary would flow across, and the defendant dug them out. In the subsequent lawsuit the defendant cited the percolating water cases and argued that an analogy existed between the flowing water and the flowing asphalt. The Privy Council met this argument with the answer "asphalt is a mineral — not water".

Although it is possible to support this decision on the ground that the plaintiff had a right to the support of his land in its natural state, the unqualified statement that the percolating water cases do not apply to minerals supports and even extends the Texas theory of absolute ownership of petroleum before it is reduced to possession. The statement carries the ownership theory to the ex-

[7] [1895] A.C. 587.
[8] [1899] A.C. 594.

treme test: What is the liability of a landowner when he drains petroleum from his neighbour's land and recovers it? The Texas courts have denied liability for drainage stating that the neighbour's fee is defeasible in such circumstances. The Privy Council found liability and assessed damages.

In 1929, in an appeal from Burma, the Privy Council again considered the ownership of petroleum before it is reduced to possession. In *U Po Naing* v. *Burma Oil Company Limited*[9] the plaintiff was the owner of several government "oil sites" and he leased his right to the company. Although the plaintiff admitted that he was not entitled to a royalty on the gas, he claimed that the use of the sites for the production of gas entitled him to compensation. The Privy Council denied this right and stated that there is no authority that the gas was the plaintiff's property before it was reduced to possession. It would be "difficult to reconcile any such view with the well-known authorities as to underground water not flowing in any defined channel".[10]

This dictum appears to support the Oklahoma non-ownership theory and is in conflict with the theory of the absolute ownership of asphalt in the *Trinidad* case. On one hand it is possible to own flowing asphalt before it is reduced to possession because it is a mineral and the percolating water cases do not apply to minerals; on the other hand, it is impossible to own percolating gas until it is reduced to possession. Yet it is clear both substances are minerals.[11]

In 1952 the Privy Council once more dealt with the ownership of oil and gas in the ground in *Borys* v. *Canadian Pacific Railway and Imperial Oil Limited*.[12] The plaintiff, who had title to all minerals except coal and petroleum, claimed an injunction against the production of gas by the defendants who had title to "all petroleum". The defendants argued that the term "petroleum" includes "natural gas" but, failing in this argument, claimed to be entitled to use such gas as was necessary to produce the oil. Lord Porter, in delivering the judgment, said that if any oil or gas situated in a landowner's property filters from it to the surrounding lands, then the former owner has no remedy. This must mean that the landowner has no ownership of the oil and gas in place. Lord Porter added, however, that for the purpose of its decision the board was "prepared to assume that the gas whilst in situ is the property of

[9] 16 I.A. 140.
[10] At p. 144.
[11] *Barnard-Argue-Roth-Stearns Oil and Gas Company Limited* v. *Alexander Farquharson*, [1912] A.C. 864; *Stuart* v. *Calgary and Edmonton Railway Co.*, [1927] 3 W.W.R. 678.
[12] (1952) 7 W.W.R. (N.S.) 546.

the Appellant even though it has not been reduced into possession".[13] He went on to say that the real question, however, was whether the respondent could use this gas to assist it in recovering the petroleum and, since the respondent was found to have the right to work the petroleum, this right diminished the appellant's estate in the gas.

The dicta of Lord Porter appear to follow the decision of the Privy Council in the *Trinidad Asphalt* case, even though the same substance of gas was dealt with in a different manner in the *Burma Oil* case.

IV. *Canadian Decisions*

The earliest Canadian decisions dealing with the oil industry came from Ontario. In Ontario, as in Pennsylvania, the first oil leases were simple variations of English mining leases and consequently the courts tended to construe a lease of oil in the same manner as a lease of coal or nickel. The English cases which determined, like the Pennsylvania ones, that the interest granted by a mining lease is a *profit à prendre* were followed.[14] In 1906 an Ontario court said of a lease, "It is a *profit à prendre,* an incorporeal right to be exercised in the land described".[15] The right thus granted was said to exist in gross, that is, to exist quite unconnected with any other estate or interest. It is readily apparent therefore that a lease of this nature is not a lease in the ordinary sense. The right may be perpetual and is made perpetual either by specifying unlimited time or simply by granting all the substance that may be found. The right carries an automatic right to commit waste.

The Ontario courts have consistently followed this finding that an oil lease conveys a *profit à prendre.*[16] As recently as 1948 the grantor of an oil lease argued that the lease was void because the duration of the term was not clearly defined.[17] The term in question was the familiar one of "ten years or so long thereafter as the

[13] At p. 559.

[14] The statement most often cited is that of Lord Cairns in *Cowan* v. *Christie* (1873), 2 Sc. App. 273, at p. 283: ". . . although we speak of a mineral lease, or a lease of mines, the contract is not, in reality, a lease at all. . . . What we call a mineral lease is really when properly considered, a sale out and out of a portion of land. It is liberty given to a particular individual, for a specific length of time, to go into and under the land, and to get certain things there if he can find them, and to take them away, just as if he had bought so much of the soil."

[15] *McIntosh* v. *Leckie* (1906), 13 O.L.R. 54, *per* Boyd C. at p. 57.

[16] *Canadian Railway Accident Co.* v. *Williams* (1910), 21 O.L.R. 472; *Stevenson* v. *Westgage,* [1942] 1 D.L.R. 369; *Fuller* v. *Howell,* [1942] 1 D.L.R. 462.

[17] *Cherry* v. *Petch et al.,* [1948] O.W.N. 378.

leased substances may be produced". Wells J. held that the oil lease was a *profit à prendre* and that, since all the substances were granted, there was no need to state a definite term.

An interesting feature of the Ontario cases is the absence of any mention of the migratory nature of oil and gas. Petroleum is treated as if it were gold or coal or nickel, and cases dealing with these solid and stationary minerals are applied with apparently little hesitation. Where the American courts have followed tortuous lines of reasoning in considering the fugacious nature of oil, the Ontario courts have simply ignored it.

The Appellate Division of the Supreme Court of Alberta has never precisely defined the interest granted by a petroleum lease. Statements appear that the interest is a *profit à prendre*, but in each case they are dicta.[18] Moreover, no case decides directly whether or not there can be ownership of the oil and gas in place. In fact, until 1952, no Alberta case mentioned the migratory nature of oil, which has been such a source of worry to the American courts, and it may be safely assumed that it was never until that time raised before a court in Alberta.

In 1952 the *Borys* case appeared before the Appellate Division of the Supreme Court of Alberta.[19] The Appellate Division seemingly adopted both the ownership and non-ownership theories. It held at the outset that "the petroleum is the property of the defendants who are entitled to do as they like with it", a statement in support of the ownership theory. The case had a second aspect: a question of how much of the surface owner's gas the owner of the oil could use in recovering the oil. In considering this second question, the court reviewed and followed the percolating water cases, Parlee J.A., for the majority of the court, stating that gas in the earth is like subterranean waters and subject to the same principles of law. In other words, the gas cannot be owned without first being reduced to possession.

With respect, the two findings are inconsistent. The court first decided who owned the oil, thereby approving the theory that oil in the ground can be owned. The court then decided that gas is like subterranean water not flowing in defined channels, and cannot be owned. Thus the ownership theory was applied to oil, the non-ownership theory to gas.

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[18] *Wulff* v. *Lundy*, [1940] 1 W.W.R. 444, at p. 459; *Vulcan Brown Petroleums* v. *Mercury Oils Ltd.*, [1942] 1 W.W.R. 138; *Re Rippel Estate*, [1948] 1 W.W.R. 695.

[19] *Borys* v. *Canadian Pacific Railway Company and Imperial Oil Limited*, (1951-52) 4 W.W.R. (N.S.) 481.

The various Alberta statutes dealing with oil and gas indicate that the legislature contemplated that ownership is possible. The Land Titles Act[20] defines land as including minerals and new provisions have been placed in the Act for the issuance of certificates of title to minerals. Moreover, the Mineral Taxation Act[21] purports to tax minerals in place. It defines an owner as a person who is registered on the certificate of title, and minerals as including petroleum and natural gas. There is no enactment directly defining the type or degree of ownership.

The courts of Saskatchewan have recently had two opportunities to define the nature of ownership of oil and gas in the ground. The first case, *Landowners Mutual Minerals Limited* v. *The Registrar of Land Titles*,[22] arose when the registrar of land titles refused to issue a certificate of title to petroleum and natural gas. The issue therefore was whether the Land Titles Act[23] contemplates a mineral title. It was argued by counsel that petroleum in the ground is legally analogous to a wild animal and that ownership cannot vest until it is reduced to possession. If this argument were followed, no title could issue. Chief Justice Martin, speaking for the whole court, refused to accept the argument, however, and held that oil and gas are part of the land. Therefore they belong to the surface owner unless they are excepted from his title and he may transfer ownership just as in the case of other minerals. The registrar was directed to issue a title, thus recognizing ownership of petroleum before it is reduced to possession.

The second case, *In re Heier Estate*, also recognized ownership.[24] The executors of an estate had granted an oil lease containing the usual provisions for payment of royalties and for the use by the company of the surface rights needed for drilling. The executors applied under the provisions of the Devolution of Real Property Act[25] to have the lease approved. The majority of the court refused approval, holding that the rights granted did not constitute a lease in the ordinary sense. The court, however, had more difficulty in deciding what the interest actually was. Martin C.J. stated that the "lease" was a sale of a portion of the land, in the form of oil and gas. Proctor and Culliton JJ.A. held that a grant of petroleum and natural gas is a grant of an interest in land. Gordon and

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[20] R.S.A., 1942, c. 205, s. 2(1).
[21] Stats. Alta., 1947, c. 10.
[22] (1952) 6 W.W.R. (N.S.) 230.
[23] R.S.S., 1940, c. 98.
[24] (1952-53) 7 W.W.R. (N.S.) 385.
[25] R.S.S., 1940, c. 108.

McNiven JJ.A. dissented, agreeing that the "lease" of minerals is a sale of land, but holding that the "lease" was severable and that the surface entry rights did actually constitute a lease the court could approve.

Thus the Court of Appeal in Saskatchewan is on record that petroleum in the ground may be owned and that a portion of the land is sold when a lease of it is granted. It was pointed out that this peculiar form of lease differs greatly from an ordinary lease, in that it grants only a limited use of the land and its essential purpose is to allow the grantee to remove minerals which may be found on the land. In reaching this decision the Saskatchewan court followed a number of English and Ontario cases which said that the interest so granted was a *profit à prendre*.

A recent case in the Supreme Court of Canada, *McColl-Frontenac Oil Company Limited* v. *Hamilton*,[26] also discusses the nature of ownership. In this case the plaintiff claimed that a lease he had granted was void because its execution did not comply with the Dower Act and the specific question before the court was whether a petroleum lease is "a contract for the sale of property" within the meaning of section 9(1) of the Act. Taschereau, Kellock and Fauteux JJ. held, following the English mining cases, that "the instrument provides for a sale of property". Estey J. reached the same result in a separate judgment and Kerwin J. dissented.

V. *Present Position*

Most courts in Canada have adopted a theory of qualified ownership similar to that in Pennsylvania, though in Alberta the relationship of the percolating water cases to oil and gas may cause some difficulty. Ontario has yet to consider the effect of the migratory characteristics of oil and gas on ownership of the substances in the ground. It has, however, such a long line of authorities dealing with an oil lease as a *profit à prendre* that it is probable that the courts will not be seriously impressed by the argument that, being fugacious, oil cannot be owned until reduced to possession.

In Western Canada the industry has assumed that interests in oil and gas may be conveyed as an interest in land, though no action has brought directly in issue the liability for drainage. If the holder of an oil lease has not an interest in land which he may protect by an action of ejectment, and for which he may obtain a Torrens title, many thousands of established transactions would

[26] [1953] 1 S.C.R. 127.

be endangered. It seems probable therefore that Canada will adopt a theory of ownership which recognizes that oil and gas may be owned without being reduced to possession.

The courts in Canada and England have not clearly recognized the distinction between ownership of a *right* to recover oil and ownership of the oil itself in the ground. In a given piece of land, part of the fee simple is the right to remove substances from it. That right of removal is described as a *profit à prendre* in the Ontario cases, and it is clear that a *profit à prendre* is an interest in land capable of being conveyed for a term of years or in its entirety. Chief Justice Martin in the *Heier Estate* case described an oil lease as being a sale out and out of a portion of the land. Thus the right to get the oil is an estate in land.

In most cases, once the issue of who has the right to get the oil is determined, there is no further problem. But can it be said that the right to win whatever oil is available is equivalent to ownership of the oil itself? We submit not. It is well recognized (apart from the *Trinidad Asphalt* case) that the oil beneath the surface of *A*'s land may flow to a position beneath *B*'s land and may there be lifted by *B* and placed in his possession. When that happens *A* has the option either of conceding that he did not have an absolute title to the oil or of calling *B* a thief.

The Ontario courts have stated that this right to recover is a *profit à prendre*. Yet this is not a complete answer, as can be seen by a reference to the classic example of a *profit à prendre*, the right to cut hay on another's land. If the right is exclusive, it is clearly an interest in the land. But this interest does not convey ownership in the hay to be grown in the future because it may never come into existence; in the same way the oil may never come into production in the future under an oil lease. Nevertheless, the *profit à prendre* conveys a better right to the future hay or future oil than is held by anyone else. We suggest that this right is a qualified property interest. It is qualified by various contingencies, and is an unvested title. A property interest exists but a possessory ownership does not.

The most satisfactory theory of ownership of gas and oil in place is found in Pennsylvania. The owner of a *profit à prendre*, the person who has the right to take the oil, has a property interest in the oil. The right is something less than an absolute ownership, in that it may be defeated, but it is nevertheless an interest in land subject to the usual conveyancing rules governing an interest in land. Briefly, the oil is part of the land so long as it is there and subject to be taken.