W. J. GREENBANK (DEFENDANT)..... APPELLANT; 1943

AND *Oct. 14, 15. *Dec. 15.

THE NATIONAL SUPPLY COMPANY LTD., AND OTHERS (PLAINTIFFS)..... } RESPONDENTS.

ON APPEAL FROM THE SUPREME COURT OF ALBERTA, APPELLATE DIVISION

Equity—Enforcible right against fund—Subrogation—Sublessees of oil rights in land financing drilling of well by issue of royalty certificates—Sublessees failing to complete, and committee for royalty holders completing well after arranging with holders of mechanics' liens for postponement of liens in favour of cost of completion and operation—Production not sufficient, after payment of cost and prior claims, to pay lienholders—Royalty holders' committee receiving dividend on claim against estate of a deceased sublessee—Claim by lienholders against fund created by said dividend.

M. and W. were sublessees of petroleum and gas rights in certain land. In the sublease they had covenanted to drill a well to commercial production or to a certain depth. As a financing plan, they entered into an agreement with T. Co. as trustee (in which they covenanted, *inter alia*, to carry out their covenants in the sublease), under which royalty certificates were issued and sold covering 70 per cent. of the production of the well (the remaining 30 per cent. being set aside for prior rights, etc.). M. and W., after drilling for a time, were unable to complete. The royalty holders appointed a committee with full powers to assume the position of M. and W. to complete the well and make arrangements and settlements with others having claims. To that committee M. and W. assigned their rights and interests in the well, and all property and equipment connected therewith. Plaintiffs had supplied materials to M. and W. and had registered mechanics' liens, which (as declared later in an order of court) attached the interests of M. and W. and all others claiming by, through or under them in the petroleum and natural gas in and under the land, and the right to take same, and the well drilled, etc. An arrangement was made between the committee and plaintiffs by which the committee might proceed to complete the well and, subject to costs of completion and operation and certain prior claims, the lienholders were to have the first claim against production proceeds. The committee completed the well and operated it for a time but production was only sufficient to pay their costs so incurred and claims having priority to plaintiffs' claims, and plaintiffs remained unpaid. Meanwhile M. had died and the committee filed a claim against his estate for money expended in bringing the well into production, the basis of the claim being that such expenditure was incurred because of breach by M. and W. of their covenant to drill the well. Said claim against the estate was allowed and a dividend paid thereon, which was paid to T. Co. to be held in trust, pending disposition of the present action, in which plaintiffs (who had also claimed against M.'s estate and received a dividend, which they credited) claimed payment out of said trust fund. Defendant G. (appellant) was by an order of court named to defend the action for the benefit of all persons interested.

*PRESENT:—Rinfret, Kerwin, Hudson, Taschereau and Rand JJ.

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Held (affirming judgment of the Supreme Court of Alberta, Appellate Division, [1943] 1 W.W.R. 42): Plaintiffs were entitled to the fund to the extent of the unpaid balance of their claims.

Per Rinfret, Kerwin, Hudson and Taschereau JJ.: Plaintiffs had a right enforcible in equity. Plaintiffs had waived their liens only to the extent of the committee's expenses and payments, for which the committee had reimbursed itself out of production. If the committee were now paid the fund in question, its cost of bringing the well into production would be reduced *pro tanto;* and the result would be a surplus of proceeds of production to which plaintiffs' liens attached.

Per Rand J.: The royalty holders, through their committee, were entitled to recoup their outlay for completion of the well out of two funds: their claim against M.'s estate and the proceeds of production of the well. As to the latter fund, plaintiffs had postponed their charge. The right against the estate was unquestionably the primary source for payment of said outlay; the proceeds of production, under the postponement, became the secondary or surety fund for that payment; and upon satisfaction by the royalty holders of their debt out of production, plaintiffs became entitled to be subrogated to the committee's claim against the estate. The proof made by the committee against the estate was, therefore, in trust for plaintiffs to the extent of plaintiffs' claims. Viewing the transaction in the converse aspect, if the estate dividend had been paid before completion of the well (or even before appropriation of the proceeds of first production), the committee would have been under a duty in relation to plaintiffs to apply the dividend toward the cost of that work; and this would have augmented the production proceeds to a like extent and that increase would have been available to the satisfaction of plaintiffs' claims.

APPEAL by the defendant Greenbank from the judgment of the Supreme Court of Alberta, Appellate Division (1), dismissing (Harvey C.J.A. and Lunney J.A. dissenting) his appeal from the judgment of Ives J. ordering that a certain trust fund of $7,187.64 and interest accumulated thereon, held by the defendant The Toronto General Trusts Corporation as trustee, should be paid (subject to prior charges allowed for getting in the fund and for certain costs) by the trustee to the plaintiffs to the extent of the unpaid balances of principal and interest of the respective liens of the plaintiffs, with interest from the date of judgment on each respective lien.

The material facts of the case, so far as relevant to the grounds of decision in this Court, appear in the reasons for judgment in this Court now reported. It might be added that the agreement between Myers and Wright (of the one part) and The Toronto General Trusts Corporation

(1) [1943] 1 W.W.R. 42.

(trustee), referred to in the reasons for judgment, contained a covenant by Myers and Wright that they would carry out all their covenants and agreements set forth in the sublease to them and would observe and perform all the terms and provisions thereof by them to be observed and performed.

M. B. Peacock K.C. for the appellant.

Leo H. Miller for the respondents.

The judgment of Rinfret, Kerwin, Hudson and Taschereau JJ. was delivered by

HUDSON J.—This is an appeal by the defendant Greenbank from a judgment of the Appellate Division of the Supreme Court of Alberta dismissing an appeal by the said defendant from a judgment of Mr. Justice Ives at the trial, holding that the trust funds in the hands of the Toronto General Trusts Corporation as trustee should be paid to the plaintiffs to the extent of the unpaid balances of their respective liens.

The statement of facts by Mr. Justice Ewing in the court below is fairly complete and I shall adopt much of it here. Myers and Wright were sublessees of the petroleum and gas rights in a parcel of land in Alberta. In this sublease they covenanted to drill a well on the land "to commercial production or to a depth of 300 feet in the limestone, whichever should first occur".

In order to finance the drilling of the well, Myers and Wright adopted a method, common in Alberta, of selling in advance the production of the well in definite proportions to individuals. To carry out this plan, they entered into an agreement with the Toronto General Trusts Corporation to act as trustee and assigned to such trustee the total production of the well, less costs of recovery and prior rights of the Crown and head lessee, for which purpose and other incidentals 30 per cent. of such production was to be set aside. The remaining 70 per cent. might be disposed of by Myers and Wright through the issue and sale of royalty certificates to be distributed by the trustee. Such disposition was made and royalty certificates issued covering all or approximately all of the said 70 per cent.

Provision was made in the trust agreement for calling by the trustee of a meeting of all the holders of royalty certificates in case of default by Myers and Wright.

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Myers and Wright commenced drilling of the well but after some months of work fell into financial difficulties and notified the trustee that they were unable to complete the well in accordance with their covenant.

In consequence of this, the trustee called a meeting of royalty holders in accordance with the terms of the trust agreement. At this meeting it was decided that the well should be taken over and completed if possible and, for that purpose, a committee was appointed and given full powers to assume the position of Myers and Wright to complete the well and to make all necessary arrangements and settlements with others having claims. Myers and Wright then assigned to this committee all their rights and interests in the well, and all property and equipment connected therewith. Meanwhile, it was necessary for the committee, in order to proceed with the completion and operation of the well, to make arrangements with those having claims against Myers and Wright in respect of the work already done. Among these were the plaintiffs, who had supplied materials for the drilling of the well, and thereby had become entitled to mechanics' liens which they had duly registered. These liens attached the interests of Myers and Wright and all other persons claiming through, by and under them in the petroleum and natural gas in and under the parcel of land in question, and the right to take same and the oil and gas well drilled on the said land, and all improvements and accessories thereto and property held in connection therewith. This was later held by the court in an order binding on all of the parties interested.

An arrangement was then made between the committee and the plaintiffs which is evidenced partly by a letter written to the committee by the National Supply Company which reads as follows:

904-10th Ave. West,
CALGARY, ALBERTA,
December 22nd, 1934.

Mr. H. M. Mack, Chairman
Pacalta Royalty Owners Committee,
317 Alberta Corner,
Mr. W. B. O'Regan, Secretary,
Mr. E. J. Gregory,
Mr. C. S. McKenzie,
Mr. Geo. Harris,

GENTLEMEN:—

In accordance with our conversation of Dec. 18th, it is our understanding that you have secured a waiver of 65 royalty units to allow

your committee to proceed to finish the Pacalta well and use the first production to pay the cost of completion and pay off Myers & Wright creditors with claims against the well.

It is also our understanding that you can make arrangements with the Calmont Oils Ltd. for the use of a Rotary outfit and a contract with Messrs. Wilkinson & Head on a 10 per cent. cost plus basis, using the first production to pay the following expenses incurred after December 8th on a pro-rata basis:

Wilkinson & Head Sept. 27th contract on a 10 per cent. cost plus basis, including any moneys due them prior to Dec. 8th.

Calmont Oils Ltd. rental on Rotary Outfit including $2,000 due them prior to Dec. 8th.

Repay new money advanced after Dec. 8th for completion account.

On Dec. 10th we filed a Lien for $4,917.43 covering an account against Myers & Wright on the Pacalta well and we will not admit any prior claims other than those above mentioned. This applies to production only.

Yours very truly,

THE NATIONAL SUPPLY COMPANY LIMITED

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and by oral evidence given at the trial by Mr. Mack, who was Chairman of the Committee and which is as follows:

Q. In other words, subject to the payment of those costs of completion, the lien holders were to get the production until their liens were paid?

A. They were to get it after we paid off the necessary completion and operation charges and other things necessary to be paid.

Q. And there was no money, none of that production was to go to the royalty holders until after the lien holders were paid?

A. That is true.

Q. That is true?

A. The lien holders were to get paid before the royalty holders got anything, before any money was paid over to the royalty holders, the lien holders; I think that in the main is the essence of the agreement which we made, that the royalty holders would stand back and when there was surplus money the lien holders would get it and we would not come in until afterwards.

Having secured this concession from the plaintiffs and made arrangements with some others, the Committee proceeded to complete the well and for a time to operate it. From the proceeds of production they were entitled to repay and did repay all operating costs, all expenditures incurred by them in bringing the well into production, and to settle the claims having priority to the plaintiffs. But they claimed that there was no surplus to pay the plaintiffs. It is admitted in the pleadings that the defendants were paid out of production for their entire expenditure and also that they had paid nothing to the plaintiffs.

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Meanwhile, Myers had died in 1935 and a claim was filed on behalf of the Committee against his estate then in the hands of the Trusts and Guarantee Company as administrators. This claim was for the money expended by the Committee on behalf of the royalty holders in bringing the well into production, the basis of this claim being that such expenditure had been incurred by reason of Myers and Wright's breach of their covenant to complete drilling the well.

In December, 1937, the plaintiffs not having received anything from the defendants on account of their liens, the plaintiffs' solicitors wrote the Chairman of the Committee as follows:

December 3rd, 1937.

LOUIS K. BOWDEN,
Chairman of the Pacalta Royalty Holders Committee.

DEAR SIR:

Re: The National Supply Company Limited

We are instructed to advise you that unless the indebtedness owing to the National Supply Company, Limited, for casing and materials supplied by the said Company and used in the drilling of the Myers and Wright well on L.S.D. 7 of Section 28, Township 18, Range 2, West of the 5th Meridian, is paid within one week from this date, our instructions are to commence action on the Mechanics' Lien filed by The National Supply Company Limited, against said L.S.D. 7, in December, 1934.

The amount owing to our client is $5,438.39 with interest thereon from the 31st of March, 1936.

Our instructions herein are definite.

Yours truly,
FORD & MILLER.

To that letter they received the following reply:

December 4th, 1937.

Mr. LEO MILLER,
%Ford & Miller,
Barristers & Solicitors,
502-504 Maclean Block,
Calgary, Alberta.

DEAR SIR:

Re: National Supply Co. Ltd.

We are in receipt of your letter of December 3rd, 1937, referring to the above account. In accordance with the writer's telephone conversation with you as of to-day, I am enclosing a financial statement taken off October 2nd, as of July 31st, 1937, by William Ireland, chartered accountant of Pacalta well.

As to the state of the above claim, the writer has discussed the matter with the other members of the Committee, and we definitely feel and go on record to say that as soon as it is possible for Mr. Skene, our

solicitor, to arrange that the Trust Co. have distribution of the monies now held by them, to the creditors credit, we will definitely protect the National Supply Co. along with the other creditors of the Pacalta well and see that all monies received by us from the above estate is paid first to the creditors before any distribution is made to the Royalty Holders. We feel that this is only fair to the creditors who have been patient and given such consideration to date.

Hoping that you will give this your consideration.

Yours very truly,

PACALTA OPERATING ROYALTY HOLDERS' COMMITTEE,

Per Louis K. Bowden,

Managing Director.

On December 20th, the solicitors for the Committee wrote a letter to the plaintiffs' solicitors confirming this position.

The claim of the Committee on behalf of the royalty holders against the Myers estate was subsequently allowed at $32,988.74, and a dividend thereon paid to Mr. Greenbank, the present defendant, as representing the Committee, which payment, on the advice of the Committee's solicitors, was made to the Toronto General Trusts Corporation to be held by them in trust pending the disposition of this action. Subsequently the present plaintiffs, having received nothing from the Committee, took action to enforce their liens and a receiver was appointed to operate the well for a time, but it was found that under the limitations imposed by governmental regulations it was impossible to operate at a profit and so far the plaintiffs have received nothing from this source.

The plaintiffs also put in a claim against the Myers estate and on this account received a dividend which has been credited on their claim.

This action was commenced against Mr. Greenbank, who had been acting as Chairman of the Committee for the royalty holders, and against the Toronto General Trusts Corporation, who was trustee under the trust agreement and also was the depositary of the funds in question. A number of claims were made but only one need be considered and that is that the plaintiffs had a charge for principal and interest due and owing under their liens, and for an order directing the defendant, the Toronto General Trusts Corporation as trustee, to pay the respective sums so due to the plaintiffs, together with the costs of this action, out of the said trust fund.

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The status of the defendant Greenbank was settled by an order of the Appellate Division (1) in the following terms:

> It is ordered that the Defendant, W. J. Greenbank, be authorized to and do defend this action on behalf of and for the benefit of all persons interested in a certain Trust Fund referred to in the pleadings of $7,187.64 and interest held by the Defendant, The Toronto General Trusts Corporation as trustee;
>
> And it is further ordered that no judgment shall be given under which recovery may be had personally against the Defendant, W. J. Greenbank, or against any of the persons interested in the said Trust Fund.

The action was tried before Mr. Justice Ives, who ordered that the trust fund in question with accumulated interest should be paid by the Toronto General Trusts Corporation to the solicitor on record for the plaintiffs, with the consent of the lienholder plaintiffs, to the extent of the unpaid balances of principal and interest of the respective liens of the plaintiffs, and also gave certain directions as to costs.

In the Appellate Division it was contended on behalf of the plaintiffs that the letters of December, 1937, above referred to amounted to an equitable assignment to the plaintiffs of the fund to the extent of their claims. Chief Justice Harvey was of the opinion that it was not sufficiently established that those purporting to represent the Committee had the power to make an assignment and, in any event, he thought that these letters did not amount to an assignment. Mr. Justice Ewing, speaking on behalf of the majority, took a different view. He stated:

> A perusal of the letter, Exhibit 25 above quoted, indicates that it is much more than a mere promise by the Committee to pay the debt due to respondents when the fund in question was received by the Committee. The letter is an undertaking on the part of the Committee "to see that all moneys received by us from the above estate is paid first to the creditors before any distribution is made to the Royalty Holders".

In the view I take of the case, it is not necessary to decide either of these points. The letters at least recognize what the agents and solicitors of the Committee regarded as equitable under the circumstances. In my opinion, independently of these letters, there was a right enforcible in equity.

The plaintiffs had liens on the property, including the oil, gas and other products. They waived these liens only

(1) See [1941] 3 W.W.R. 711.

to the extent of enabling the Committee to reimburse themselves for expenditures incurred in bringing the well to production and paying the other charges mentioned. The Committee did reimburse themselves out of production and, if now paid the money in question, their cost of bringing the well into production would be reduced *pro tanto*. The result would be a surplus of proceeds of production to which plaintiffs' liens attached.

I agree with the majority of the Appellate Division and would dismiss the appeal with costs.

RAND J.—The respondents recovered a judgment in a mechanics' lien action declaring them to be entitled to a lien against an oil well, property appurtenant to it and its production.

The lien was for materials supplied by the respondents to the sub-lessees of an oil lease covering a legal subdivision granted by the Province of Alberta. The sub-lessees had charged seventy per cent. of the net production and proceeds under a trust for the benefit of purchasers of units of interest, called "royalties", in these proceeds. The sub-lessees assumed the obligation of drilling a well on the subdivision, but before the work was finished they met with financial difficulties and finally threw up the job, leaving substantial liabilities outstanding, including the claims of the respondents. The trustee at once convened a meeting of the royalty holders, who decided to try to salvage something of their investment through completion of the well. A committee was appointed for that purpose and was given full authority to deal with matters necessary to that end. It obtained from the respondents and other secured creditors waivers or postponements of their charges on the production proceeds to, or in favour of, the cost of completion and certain other pressing claims; and under that arrangement the well was brought in. The output, however, did not come up to expectations and was insufficient to meet more than current costs and preferred claims. Out of the production proceeds a sum of approximately thirty-two thousand dollars was paid for work for which the sub-lessees, under their contract with the trustee, were responsible.

In the meantime one of the sub-lessees died and the other became evidently insolvent. The two estates were, by arrangement between all creditors, combined for the

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purpose of proof and distribution. The committee proved for the amount so expended, namely, thirty-two thousand dollars, on which a dividend of something over seven thousand dollars was received. It is the right to that money which forms the subject-matter of this controversy. It is claimed both by the respondents and by the committee.

A great deal of discussion took place over the authority of the committee from time to time to make binding arrangements with the respondents and other secured creditors. Apart from the fact that about sixty-five units out of a total of seventy were represented at all meetings and approved all action taken by the committee, no holder except the defendant—who was presented with a qualifying interest of a small fraction of one unit—has in this action challenged any agreement made by the committee with the respondents. There can be no doubt that the claims of the respondents were agreed to and accepted by the committee as being secured by a first charge on the production of the well, and for that reason the postponement was obtained. But under the declaratory judgment, that charge was incontestable and, in the view I take of its consequences, I do not find it necessary to pass upon the question whether the committee did in fact assign to the respondents the benefit of the proof made against the estate.

The situation is, therefore, clear. The production of the well became, by reason of the arrangement, subject to a first charge in favour of the committee to the extent of the cost of completing the well, to a second charge in favour of the respondents, and then to the trust charge for the royalty holders. At the same time the committee held the right to prove against the estate for the completion cost. The royalty holders, therefore, through their committee, were entitled to recoup their outlay out of two funds, to one of which the respondents had postponed their charge. The right against the estate was, unquestionably, the primary source for the payment of the completion cost: the production proceeds, under the postponement, became the secondary or surety fund for that payment; and upon the satisfaction by the royalty holders of their debt out of those proceeds, the respondents become entitled to be subrogated to the claim of the committee

against the estate. The proof that was made by the committee was, therefore, in trust for the respondents to the extent of their claims.

Viewing the transaction in the converse aspect and as Ewing J.A. observes, if this dividend from the estate had been paid in before the completion of the well (or even before the appropriation of the proceeds of first production), the committee would have been under a duty in relation to the respondents to apply it toward the cost of that work. This, in turn, would have augmented the production proceeds to a like extent and that increase would have been available to the satisfaction of the claims of the respondents.

The appeal should, therefore, be dismissed with costs.

Appeal dismissed with costs.

Solicitors for the appellant: *Peacock, Skene & Gorman.*

Solicitor for the respondents: *Leo H. Miller.*