Court of Queen’s Bench of Alberta

Citation: Desoto Resources Limited v. Encana Corporation, 2009 ABQB 337

2009 ABQB 337 (CanLII)

Date:20090602
Docket: 0401 09040
Registry: Calgary

Between:

Desoto Resources Limited

Plaintiff

\- and -

Encana Corporation and Pan Canadian Petroleum Limited

Defendants

Memorandum of Decision
of
J.L. Mason, Master in Chambers

Introduction

[1] The Defendants, Encana Corporation and Pan Canadian Petroleum Limited (“Encana”) apply for summary dismissal of the Plaintiff’s claim pursuant to Rule 159(2) of the Alberta *Rules of Court*.

Background

[2] Encana is the owner of all mines and minerals underlying sections 5 and 7 of 38-24-W4M and section 13 of 38-25-W4M (the “Lands”). Encana granted petroleum and natural gas leases in the Lands, in which the Plaintiff, Desoto Resources Limited (“Desoto”) claims a beneficial interest (“Leases”).

[3] The Leases were originally granted in 1974 and 1975 and continued by inclusion in the Joffre Sand Unit No. 3.

[4] The Leases were issued for primary terms ranging from 3-5 years and continued "so long as any of the leased substances is being produced or is capable of production in paying quantities from a well or wells on the [Lands] at the end of the primary term."

2009 ABQB 337 (CanLII)

[5] Desoto's predecessor Jofco Resources Inc. ("Jofco") held an interest in the Leases when production ceased and the Unit terminated in 1998.

[6] The wells were shut in by Energy and Utilities Board ("EUB") order in June 1998, and the EUB issued abandonment notices in September, 1998. By the end of 1998, none of the wells drilled on the Lands were in production due to an order by the EUB relating to the payment of a well abandonment deposit.

[7] Jofco filed proceedings under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("BIA") in 1999, resulting in an assignment of the Leases to Penn West Petroleum Ltd. ("Penn West") and Cansearch Resources Ltd. ("Cansearch"). Encana was a party to this assignment. Penn West and Cansearch entered into trust agreements to hold interests above and below the Viking Zone in trust for Desoto.

[8] A proposal was made and approved by Desoto's creditors, including Encana, who was an unsecured creditor in the amount of $56,000.00 arising from unpaid royalties. Under the proposal, Encana agreed to forego its right to terminate the Leases in exchange for treatment of its unsecured claim as a secured claim in Desoto's bankruptcy proceedings. The proposal was approved by Cairns J. on July 15, 1999.

[9] On July 8, 2002, Encana wrote to the EUB and confirmed that Penn West had "active Petroleum and Natural Gas leases" in section 5 of the Lands.

[10] On December 23, 2002, Desoto's agent notified Encana of its intention to drill a well at 11-13-38-25-W4 of the Lands. Encana provided its coal waiver on December 30, 2002. This well was apparently never drilled.

[11] In March, 2003, Desoto advised Encana it wanted to drill a new well in section 7 of the Lands. Desoto also indicated it wanted to drill a well in section 13. In response, Encana stated that it would be issuing a default to Penn West.

[12] Ultimately, however, Encana instead served a Notice of Lease Termination on Penn West and Cansearch on July 16, 2003. Penn West and Cansearch, by letter dated September 24, 2003, agreed that the Leases had terminated by their terms.

[13] On April 19, 2004, Encana served Desoto with notices to take proceedings on caveats it had filed on the Lands, with respect to its claimed beneficial interest.

[14] Desoto filed this action in response, alleging a beneficial interest in the Leases by virtue of the trust agreement with Penn West and Cansearch and claiming that the Leases were currently producing oil and gas or capable of same.

2009 ABQB 337 (CanLII)

[15] After commencing this action, Desoto:

a. Applied to the EUB for a well license without notice to Encana or disclosure of the action;

b. Drilled a new well, notwithstanding a pending EUB hearing to review the license and its commitment not to drill; and

c. Asserted at the EUB hearing that the new well extended the Leases, "notwithstanding expiry of the primary term of the [Leases]"(EUB Decision 2008-047).

[16] The EUB suspended the well license and ordered abandonment of the well as it found Desoto did not have the right to produce the minerals under the *Oil and Gas Conservation Act*, R.S.A. 2000, c.O-6 "due to expiry of the primary term and failure by the lessees to continue the leases under the terms of the habendum clause." Desoto sought but was refused leave to appeal that decision to the Court of Appeal: 2008 ABCA 349. The parties did not raise the issue of *res judicata* in this application.

Summary of Position of the Parties

[17] Encana submits that it is clear under the terms of the Leases that they have terminated, given that no well drilled during the primary term was producing or capable of production.

[18] Desoto submits that the Leases have not terminated because there is still production capacity, and further that Encana is estopped from denying the existence of the Leases, as it affirmed their existence in Jofco's BIA proceedings in 1999, and in further communications after that time. Desoto also asserts that Encana could have instead issued a notice of default under the Leases and thereby allowed Desoto an opportunity to bring shut in wells back into production, or alternatively drill and produce new wells.

Analysis

The test for summary judgment

[19] As noted by the Supreme Court of Canada in ***Canada (Attorney General) v. Lameman***, 2008 SCC 14 at para. 10:

> The summary judgment rule serves an important purpose in the civil litigation system. It prevents claims or defences that have no chance of success from proceeding to trial.

> Trying unmeritorious claims imposes a heavy price in terms of time and cost on the parties to the litigation and on the justice system. It is essential to the proper operation of the justice system and beneficial to the parties that claims that have no chance of success be weeded out at an early stage. Conversely, it is essential to justice that claims disclosing real issues that may be successful proceed to trial.

2009 ABQB 337 (CanLII)

[20] For these reasons, the bar on a motion for summary judgment is high. The applicant bears the evidentiary burden of showing that there is no genuine issue of material fact requiring trial. This must be proven, and not merely supported by references to allegations or pleadings. If the applicant meets this burden, then the respondent must either refute or counter the applicant's evidence, or risk summary dismissal. Each side must "put its best foot forward" with respect to the existence or non-existence of material issues to be tried: ***Canada (Attorney General) v. Lameman*** at para. 11.

[21] The Supreme Court emphasized the importance of evidence supporting or refuting the motion in ***Canada (Attorney General) v. Lameman*** at para. 19:

> In the Court of Appeal and here, the case for the plaintiffs was put forward, not only on the basis of evidence actually adduced on the summary judgment motion, but on suggestions of evidence that might be adduced, or amendments that might be made, if the matter were to go to trial. A summary judgment motion cannot be defeated by vague references to what may be adduced in the future, if the matter is allowed to proceed. To accept that proposition would be to undermine the rationale of the rule. A motion for summary judgment must be judged on the basis of the pleadings and materials actually before the judge, not on suppositions about what might be pleaded or proved in the future.

[22] The Alberta Court of Appeal in ***Tottrup v. Clearwater***, 2006 ABCA 380 stated that where the outcome of the case depends on the interpretation of a particular document or a legal issue arising from undisputed facts, the test is whether the question can be fairly decided on the record before the court:

> In some cases the facts are clear and undisputed. The ultimate outcome of the case may depend on the interpretation of some statute or document, or on some other issue of law that arises from undisputed facts. In such cases the test for summary judgment is not whether the issue of law is "beyond doubt", but whether the issue of law can fairly be decided on the record before the court. If the legal issue is unsettled or complex or intertwined with the facts, it is sometimes necessary to have a full trial to provide a proper foundation for the decision. In other cases it is possible to decide the question of law summarily.

Term of the Leases

[23] In this case, the Leases provide as to term:

> The Lessor, for the initial consideration paid by to the Lessor by the Lessee...DOES HEREBY GRANT AND LEASE...the leased substances...**for the primary term and so long thereafter as any of the leased substances is being produced or is capable of production in paying quantities from a well or wells on the said lands at the end of the primary term**, but subject to sooner termination as provided in this lease; **provided that if at the expiration of the primary term each well drilled on the said lands by the Lessee is abandoned and the Lessee is then drilling a further well on the said lands for the leased substances, this Lease shall remain in force so long as such drilling is diligently and continuously prosecuted and so long thereafter as any of the leased substances is being produced or is capable of production in paying quantities from the said lands from the well so drilled**.[Emphasis added.]

2009 ABQB 337 (CanLII)

[24] Thus, the Leases continue past the primary term only where:

a. Production continues or is capable of continuing in paying quantities from wells on the Lands at the end of the primary term of each lease; or

b. At the time the primary lease expired, wells had been drilled but abandoned, and the lessee was drilling a new well and such drilling was diligently and continuously prosecuted and so long as production or capability for production in paying quantities continues.

[25] Desoto's deponent, Donald Benson, confirms that there had been no production of oil and gas from any wells on the Leases since 1998. Thus, the Leases cannot continue on the basis of actual production.

[26] There is an absence of evidence as to the existence of wells drilled in the primary term, capable of production in paying quantities. Mr. Benson states his belief that the "lands" are capable of producing oil and gas in paying quantities, and points to the well drilled by Desoto in 2007. He notes that while this well is not currently in production, it has been tested and reserves are estimated at 770,000 MCF. No evidence of costs of production was submitted.

[27] Whether or not the Lands are capable of production in paying quantities, the plain terms of the Leases require that the production be from a well or wells drilled during the primary term. A well drilled in 2007 cannot operate to satisfy this requirement.

[28] As stated by the Alberta Court of Appeal in ***Freyberg v. Fletcher Challenge Oil & Gas Inc***., 2005 ABCA 46 at para. 58:

> What reported Canadian decisions disclose is that when a lessee does not perform - in the sense of drilling, paying or producing - and any term is dependent on such performance, the lease terminates...The principle, and the logic upon which the principle is based, remain the same regardless of when the failure to produce occurs.

[29] Strict construction of term provisions of oil and gas leases is consistent with the policy considerations reviewed by the Court of Appeal in ***Freyberg v. Fletcher Challenge Oil & Gas Inc.*** at paras. 49-54, paraphrased as follows:

a. The desire by individual lessors to produce the well as soon as possible and certainly within their lifetime is to be respected;

b. The exigencies of the marketplace encourage production whenever it is economical and profitable;

c. The risk of flooding increases while production is delayed;

d. Delayed production increases the possibility that the gas of an inactive well will be "captured" by other wells in the same formation; and

e. Automatic termination allows a lessee to choose to forsake a lease to pursue more attractive opportunities without liability for damages.

[30] There has been no production since 1998, and there is no evidence to support capacity for production in paying quantities from wells drilled in the primary term. The clear words in the habendum clauses of the Leases dictate that absent production or capacity to produce from a well drilled during the primary term, the Leases terminate. The record before the court permits this determination, consistent with ***Tottrup v. Clearwater***.

Estoppel

[31] Desoto also resists the summary dismissal application on the basis that Encana is estopped from denying the existence of the Leases, since Encana affirmed their existence in 1999 in connection with Jofco's BIA proceedings, at which time none of the Leases were producing oil and gas. Desoto asserts that since there has been no change in the status of production since that time, Encana is estopped from now asserting that the Leases have terminated.

[32] This does not support an estoppel in the circumstances of this case. While Encana may have affirmed the Leases at the time of Jofco's BIA proceedings, there is no suggestion that Encana was affirming the existence of the Leases indefinitely. Rather, the evidence indicates that Encana affirmed the existence of the Leases to preserve value in the estate and permit the proposal to succeed, in exchange for upgrading its claim for unpaid royalties to a secured claim. Robert Taylor, the trustee involved in Jofco's proposal, confirmed on cross-examination that Encana's agreement "was for the purposes of getting a proposal accepted, and that it would then fall to Jofco/ Desoto to do what was required in the future." After the proposal was accepted by Jofco's creditors and approved by the court, there was no drilling activity on the Leases until 2007, well after Encana had issued the Notice of Termination.

2009 ABQB 337 (CanLII)

[33] Desoto also relies on the letter sent by Encana to the EUB dated July 8, 2002 stating that Penn West had active oil and gas leases in the Lands and the coal waiver supplied by Encana in December 2002. Neither of these suggest the Leases will continue indefinitely. Further, the point remains that after this letter and coal waiver, there was, as noted, no drilling activity on the Leases until 2007.

2009 ABQB 337 (CanLII)

[34] Moreover, estoppel requires an element of reliance and detrimental changing of position: see for example, J. Ballem, *The Oil and Gas Lease in Canada*, 4th ed. (Toronto: University of Toronto Press, 2008) at 402-403 and 423. Desoto asserts that Encana's affirmation of the Leases led Desoto to apply for and ultimately drill the well in 2007, on the belief and understanding that the Leases were valid and subsisting. As noted, however, Desoto did not take any steps to drill the well until after Encana had issued the Notice of Termination on July 16, 2003, after it applied for the license without notice to Encana, and after it commenced these proceedings in response to Encana's notice to take proceedings on its caveat. These facts belie any such reliance. Desoto has failed to raise an evidentiary basis to resist summary dismissal on the basis of estoppel.

Notice of Default

[35] Desoto submits that Encana made a conscious and deliberate choice to issue a Notice of Termination rather than a Notice of Default, as it knew Desoto was in a position to arrange for the shut in wells to start producing. There is no evidence before the court that Desoto was in such a position beyond the bald statement in Mr. Benson's affidavit to this effect. Further, this is a permissive and not mandatory provision of the Leases and without more, a party to an oil and gas lease is not required to exercise only those contractual options most beneficial to its counter party.

[36] Desoto also points to new leases entered into between Penn West and Encana with respect to the Viking zone, and Mr. Benson deposes to a "concern" that Penn West and Encana may have colluded and conspired to arrange for the termination of Desoto's interest in the Leases. This is speculation, not evidence sufficient to defeat this application.

[37] Desoto's obligation as respondent in this application is to "put its best foot forward". Desoto's suggestion that further evidence may be elicited in support of its claims is insufficient to resist summary dismissal.

Conclusion

[38] Encana's application for summary judgment is granted. If the parties cannot agree, they may speak to costs within 30 days of the date of this Memorandum.

Heard on the 4th day of May, 2009.
Dated at the City of Calgary, Alberta this 2nd day of June, 2009.

J.L. Mason
M.C.C.Q.B.A.

2009 ABQB 337 (CanLII)

Appearances:

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