In the Court of Appeal of Alberta

Citation: Desoto Resources Limited v. Encana Corporation, 2011 ABCA 100

Date: 20110401
Docket: 1001-0229-AC
Registry: Calgary

Between:

Desoto Resources Limited

Appellant
(Plaintiff)

- and -

Encana Corporation and PanCanadian Petroleum Limited

Respondents
(Defendants)

The Court:

The Honourable Chief Justice Catherine Fraser
The Honourable Madam Justice Elizabeth McFadyen
The Honourable Mr. Justice Frans Slatter

Memorandum of Judgment

Appeal from the Judgment by
The Honourable Mr. Justice W.A. Tilleman
Dated the 5th day of July, 2010
Filed on the 10th day of August, 2010
(2010 ABQB 448, Docket: 0401-09040)

Memorandum of Judgment

The Court:

[1] The issue on this appeal is whether it was possible or appropriate to summarily dispose of this action based on the record before the court.

Facts

[2] Desoto claims that it is the beneficial owner of leasehold interests in certain leases acquired originally by PanCanadian Petroleum Limited, predecessor to the respondent Encana Corporation. Originally, PanCanadian entered into two petroleum and natural gas leases in 1974 and 1975 with Penn West Petroleum. The interest in those leases was ultimately acquired by Desoto's predecessor, Jofco Resources Inc.

[3] The leases were issued for primary terms ranging from 3-5 years and, under a habendum clause 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". In June 1998, the wells were shut in by order of the Energy and Utilities Board, and abandonment notices were issued to Jofco by the EUB in September 1998. At that time, there were 25 wells in existence.

[4] In 1999, Jofco entered into bankruptcy proceedings. Numac Energy Inc. offered to buy certain of Jofco's assets. It was a condition of Numac's purchase that Numac receive written confirmation from PanCanadian that the leases were in good standing and could be assigned to Numac. The trustee in bankruptcy then circulated a proposal which included Numac's offer to Jofco's creditors and stakeholders, including PanCanadian. The trustee reported to the creditors as follows:

> Although PanCanadian does not have a secured claim, it is the owner of certain mineral rights on the majority of Jofco's oil and gas properties. The values of the properties owned by the Company lie with the mineral rights. In the event PanCanadian terminated these petroleum and natural gas leases it would effectively dissipate the majority of the value attributable to these properties. PanCanadian is prepared to forego its rights of termination in return for its claim against the Company having priority. (EKE A19)

That proposal was accepted by Jofco's creditors, including PanCanadian. It was then approved by a Queen's Bench judge in July 1999.

[5] Numac executed a declaration of trust whereby Jofco acquired a beneficial interest in the leases. PanCanadian, Jofco and Numac executed a Memorandum of Assignment dated November 29, 1999 whereby PanCanadian accepted the assignment of the leases to Numac. Numac agreed to "be bound by, observe and perform the duties and obligations" of the lessee.

[6] Numac and PanCanadian later entered into agreements reducing the royalty rates payable under the leases from 25% to 15%. PanCanadian agreed that "The Lease, as amended herein, is hereby ratified and confirmed.".

[7] In March 2000, Numac assigned 50% of its interest in the leases to Cansearch Resources Ltd. Again, PanCanadian consented to the assignment. Subsequently, Penn West became the successor in interest to Numac, resulting in Penn West and Cansearch being trustees of Jofco's interests in the leases. Jofco changed its corporate name to Desoto.

[8] In May 2001, Desoto registered caveats claiming a beneficial interest in the non-Viking Zone areas of the leases. Desoto acquired land adjacent to the subject lands.

[9] In July, 2002, Encana sent a letter to the EUB confirming that Penn West had active petroleum and natural gas leases in section 5-38-24-W4M. Those leases included Desoto's interest in that section 5.

[10] In December, 2002, Desoto's agent notified Encana of its intention to drill a well on certain of the leased lands. That same month, Encana endorsed the letter and provided a "coal waiver".

[11] Desoto obtained a well licence from the EUB for production from a certain zone area on the leased lands.

[12] In March 2003, Desoto advised Encana that it wanted to drill new wells under the leases, including in connection with a pooling agreement it was entering into with Regent Resources Ltd. On March 14, 2003, Encana advised Desoto by e-mail that it was taking the position that the leases were no longer valid and that it would be issuing a default notice to Penn West on the leases (EKE A53). Encana was prepared to negotiate a new lease, but at the then prevailing royalty rate of 22.5%. Desoto subsequently drilled and cased a pooling well on May 29, 2003.

[13] On July 16, 2003, Encana served a Notice of Termination on Penn West and Cansearch as trustees of Desoto's claimed interest in the leases on the basis that the leases had terminated for want of production.

The Proceedings to Date

[14] This action was started when Encana sent notice to Desoto to commence proceedings on its caveats. Desoto commenced this action seeking a declaration that the caveats were valid, which required a finding that the leases protected by the caveats were valid. In addition to that primary relief, Desoto alleged Encana was "estopped from denying the validity" of the leases, and also alleged actionable misrepresentation.

[15] After pleadings closed, Encana applied for summary judgment on the basis that the leases had terminated, given that no well drilled during the primary term was producing or capable of

production. The Master granted summary judgment, finding that there was no production after 1998, so the leases had terminated according to their terms. She found there was no estoppel preventing Encana from asserting that termination: ***Desoto Resources Ltd. v. Encana Corp.***, 2009 ABQB 337, 473 A.R. 94.

[16] Desoto appealed that summary judgment, but also attempted to amend the Statement of Claim to add new causes of action. Those amendments were disallowed by this Court: ***Desoto Resources Ltd. v. Encana Corp.***, 2010 ABCA 110, 487 A.R. 138.

[17] The appeal from the Master to a judge was then heard and dismissed. The chambers judge found that the leases terminated by their own terms in 1998 for want of production and lack of capacity to produce in paying quantities from any well drilled in the primary term: ***Desoto Resources Ltd. v. Encana Corp.***, 2010 ABQB 448, 31 Alta. L.R. (5th) 282, paras. 37-40. He also rejected the notion of the formation of a new contract on the basis that this Court's decision denying Desoto the right to amend its statement of claim implicitly meant that Desoto could not claim the creation of a new lease agreement.

[18] Instead, the chambers judge focused solely on the issue of estoppel. He concluded that there was no material issue for trial in that Encana was not estopped from denying the existence of the Leases on the basis of: (a) promissory estoppel; (b) estoppel by acquiescence; or (c) estoppel by deed. Desoto appealed to this Court, arguing that this is not a proper case for summary dismissal, and that a trial is needed.

Standard of Review

[19] The parties agree that the standard of review of a decision to grant summary judgment is reasonableness, and that the identification of the legal test for summary judgment is a question of law for which the standard of review is correctness: ***Tottrup v. Clearwater (Municipal District No. 99)***, 2006 ABCA 380, 68 Alta. L.R. (4th) 237 at para. 8. An appeal court reviewing a summary judgment decision will be reluctant to interfere where the chambers judge has stated and applied the proper principles and where there was evidence to support the findings made and inferences drawn: ***De Shazo v. Nations Energy Co.***, 2005 ABCA 241, 48 Alta. L.R. (4th) 25 at para. 16; ***Wolfert v. Shuchuk***, 2003 ABCA 109, 15 Alta. L.R. (4th) 5 at para. 9. Absent palpable and overriding error, findings of fact and inferences drawn will not be overturned: ***Housen v. Nikolaisen***, 2002 SCC 33, [2002] 2 S.C.R. 235 at para. 10; ***Dow Chemical Canada Inc. v. Shell Chemicals Canada Ltd.***, 2010 ABCA 126, 25 Alta. L.R. (5th) 221 at para. 10; ***De Shazo***, *supra*; ***Wolfert***, *supra*.

Scope of the Remaining Issues

[20] Encana argued, and the chambers judge accepted, that the arguments now available to Desoto are limited by the previous decision of this Court refusing leave to amend the pleadings, or because of concessions made by counsel in light of that previous decision.

[21] The chambers judge held that the previous decision of this Court prevented certain of Desoto's arguments:

> 40. . . . I have already found that there is no merit to the arguments that the Leases continued on the basis of actual production or on the basis of the wells being capable of production, therefore the Leases terminated in 1998 when production ceased. Thus, extension of the Leases after termination of the Leases could occur only through estoppel (which will be addressed below) or the formation of a new contract.

In a footnote he went on to say:

> However, the issue of whether a new contract was formed has been disposed of by the Court of Appeal's holding that allegations of an agreement resulting from Jofco's restructuring in bankruptcy were not sufficiently connected to the proceedings to be added to the existing action under s. 6(2) of the *Limitations Act*, R.S.A. 2000, c. L-12 and are statute barred. Therefore, because this argument is statute barred it cannot be considered by this Court.

We do not read the previous decision of this Court as limiting Desoto's pleading to an assertion of estoppel only.

[22] It must be recalled that the original action was for a declaration that the leases were still valid. In the argument in support of amending the pleadings, it was conceded that the limitation period had expired, precluding the addition of new, unrelated actions. This Court accordingly disallowed the pleading of a "new contract", as the chambers judge correctly observed. But nothing was said about the scope of the existing pleading to the effect that the leases were still valid. No application had been brought to limit or strike the existing allegations. That original pleading required a finding of the terms of the leases, whether they were amended, extended or renewed, and if so on what terms, and an examination of whether there was a breach of those terms. This Court also specifically said at para. 11: "We decline to say anything about the scope of the existing estoppel pleading."

[23] While the previous decision of this Court disallowed the pleading of any <u>new</u> agreement, it did not restrict any arguments in support of the validity of the leases, as originally pleaded. Desoto is still able to argue that the original leases had been amended, extended or renewed by PanCanadian's actions at the time of the 1999 bankruptcy, or that those events created an estoppel.

[24] The issues on the summary judgment application were summarized by the Master as follows:

> 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.

It is clear that the Master understood that the effect of the 1999 bankruptcy events was relevant to the claim. She recited the argument that Desoto was entitled to a reasonable opportunity to put the leases into good standing. Nothing said by this Court in the pleadings decision narrowed those issues.

[25] The subsequent conclusion by the chambers judge (on appeal from the Master) that Desoto was not able to make any arguments based on the 1999 bankruptcy events went too far. Desoto was precluded from arguing a new agreement, but not from arguing the terms of the existing leases, whether they were amended, extended or renewed, and any estoppel that arose from the 1999 bankruptcy events.

[26] Encana also argued that Desoto's counsel had conceded certain issues before the chambers judge. The intended scope of the concession is unclear, but it was described by the chambers judge as follows:

> 35 In oral argument, Plaintiff's counsel conceded that in light of the Court of Appeal's decision the Plaintiff's argument (on whether there was actual production or capable of production under the Lease) no longer applies, and all that remains is the Plaintiff's argument in estoppel.

This is problematic, because the prior reasons of this Court make no mention of production or capacity to produce. Whatever concession was made is unclear, and was likely based on the same misapprehension about the scope of the previous decision of this Court. The concession is not an impediment on this appeal.

Availability of Summary Judgment

[27] Summary judgment is not available when the record discloses genuine issues of fact that must be resolved at a trial. There are such issues on this record.

[28] When Desoto was trying to restructure in bankruptcy, it held some leases with potential value, but that value only existed if the leases were not in default. PanCanadian was prepared to cooperate in the restructuring in return for secured creditor status. It seems that the parties have as yet been unable to find a clear record of the arrangement that resulted at the time of the 1999 bankruptcy. This may mean that it either was never prepared, or it has been lost. Counsel thought there might be some documentation in existence on the subject, and perhaps some of the participants have a clearer recollection of the exact agreement. All that is on this record is the report of the trustee in bankruptcy (set out, *supra*, para. 4), which gives secondhand information about what the 1999 bankruptcy arrangement encompassed. While the summary judgment application has been

argued largely based on estoppel, it may turn out that the real issue is the scope of the 1999 arrangement mentioned in this report. The real issue may be how far the 1999 bankruptcy arrangement went, or the extent to which Desoto could reasonably rely on it.

[29] There are a number of possible and reasonable interpretations of the 1999 bankruptcy arrangement. The following possibilities are identified only to illustrate that there are genuine issues for trial on this record:

> a. Encana possibly agreed to a perpetual and permanent waving of its right to ever complain about breaches of the leases. In other words, Encana not only waived any existing breaches, but waived all continuing or potential future breaches as well. This interpretation may be commercially unreasonable, and may be inconsistent with the covenant in the assignment to Numac that the assignee "shall and will be bound by, observe and perform the duties and obligations" under the leases.
>
> b. A second possible interpretation is that Encana was only waiving any breaches that existed as of the date of the 1999 bankruptcy. Since it appears that the leases were not producing at that time, this would have meant little. The next day after the 1999 bankruptcy, the leases would again have been in breach as a result of non-production, resulting in termination. This would have defeated the whole point of allowing the restructuring of Desoto to proceed by preserving the value in the leases. This interpretation also may be commercially unreasonable.
>
> c. A third possibility is that Encana waived any existing breaches, and also extended a reasonable opportunity for the assignee of the leasehold interests and Desoto to place the leases back into good standing. That opportunity might possibly have been:
>
> i) a fixed period of time,
> ii) a reasonable period of time, or
> iii) until a reasonable period of time after Encana gave notice of default.
>
> This interpretation may be consistent with the objective of the transaction, which was to allow a restructuring of Desoto.
>
> d. A fourth possibility is that Encana waived any existing breaches, and agreed to amend, renew or extend the leases for a further period, during which time DeSoto could bring the leases into good standing. This interpretation may be consistent with the objectives of the arrangement.

There may be other possible terms of the 1999 bankruptcy arrangement that will arise if further documentary or oral evidence is uncovered. The point is that the uncertainty over this key fact precludes summary judgment. Setting the rights of the parties, interpreting the significance of their

later conduct, and measuring any estoppel that may arise, requires a finding of fact on the exact nature of the 1999 bankruptcy arrangement.

[30] There are other issues of fact that raise genuine issues for trial. In particular, there are a number of post-assignment acts by Encana that are said to raise an estoppel, such as the royalty amending agreement and the coal waiver. Do these steps amount to representations that can support some sort of estoppel, or are they merely actions that are consistent with the 1999 bankruptcy arrangement's covenant that the leases will remain valid for some period of time? The impact of these steps is coloured by the specific wording of the leases and other agreements, and may also depend on the knowledge, intentions and mind-set of the Encana representatives involved in each step, which are also triable issues.

[31] Other disputed facts are evident on this record. For example, what is the significance of Desoto having drilled a well in May of 2003, in the face of Encana's termination e-mail of March 2003? Was Desoto entitled to drill because the leases were still valid? Was there any "reasonable reliance" on any estopping event at this stage? Was Encana entitled to terminate the leases in 2003? (While the Master and the chambers judge both concluded the leases were not producing in 1999, neither considered the status of the leases in 2003, having regard to the 1999 bankruptcy arrangement.)

[32] In all the circumstances, this case is unsuitable for summary judgment. It is true that many of the issues (such as those relating to estoppel) are issues of law, which are often amenable to summary judgment. There is no rule that estoppel cases cannot be decided summarily, if the evidence does not raise an issue for trial: ***Blair v. Desharnais***, 2005 ABCA 272, 52 Alta. L.R. (4th) 54; ***Ryan v. Moore***, 2005 SCC 38, [2005] 2 S.C.R. 53; ***Gillis v. New Glasgow (Town)***, 2009 NSCA 66, 280 N.S.R. (2d) 138. But in this case the issues of law are "complex or intertwined with the facts": ***Tottrup v. Clearwater*** at para. 11. There are numerous genuine issues requiring a trial.

Conclusion

[33] In conclusion, the appeal is allowed and the summary judgment is set aside.

Appeal heard on March 10, 2011

Memorandum filed at Calgary, Alberta
this 1st day of April, 2011

Fraser C.J.A.

As authorized by: McFadyen J.A.

Slatter J.A.

Appearances:

T.S. Ellam and H.M. Rosenberg
for the Appellant

C.J. Popowich and K. Reiffenstein
for the Respondents